31 March 2015

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES, ACT, 2600

Email: fsi@treasury.gov.au

Dear Treasury,

AFA Submission in Response to the Financial System Inquiry Final Report

The Association of Financial Advisers Limited ("**AFA**") has served the financial advice industry for over 65 years. Our aim is to achieve *Great Advice for More* Australians and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians' reach their potential through building, managing and protecting wealth.

Introduction

Trust in financial advice is absolutely critical. The recent media coverage of financial advice matters and the political process with respect to the FoFA Amendments and a number of inquiries have put a real spot-light on advice failures. This has put trust in financial advice into question. The media have served to highlight the public concerns. The financial services industry needs to accept accountability where things have gone wrong.

Our concern, however is that this debate has reached a point where the assumption seems to be that most financial advice is poor. This is simply wrong. The majority of financial advice is of good quality

and it has a very real, positive impact upon the clients. The full benefits of financial advice are really only appreciated by those who are clients of financial advisers.

In our opinion, there are a number of statements in the FSI report that appear to question the value of financial advice and seem to be seeking alternative solutions for clients. This is inappropriate. The focus should be on how we improve financial advice to ensure that the cases of poor advice are significantly reduced so that the Australian community can have a high level of trust in financial advice and seek it's benefits. We address some of these statements in our response below.

Financial advice is beneficial for the nation as a whole as an increased level of preparation for retirement leads to a reduction in dependence upon the public (age) pension, and holding appropriate levels of personal life insurance similarly relieves the public burden that results from either serious injury or illness, or premature death.

Our goal at the AFA is to achieve Great Advice for More Australians and inherent in that is raising the public perceptions of financial advice through engaging and educating, whilst at the same time, continuing to provide leadership to advisers on the standards and behaviours required of them to earn the public's trust and support.

Consultation Process

Thank you for the opportunity to provide feedback on the Financial System Inquiry (FSI) Final Report.

We appreciated the opportunity to participate in the FSI process during the course of late 2013 and throughout 2014. We note the consultative nature of this Inquiry, however we make the point that we were extremely disappointed to see a recommendation made in the final report with respect to the remuneration of financial advisers for life insurance products (Recommendation 24), without consultation with the AFA on this issue. Our heritage suggests we are the most recognised professional association for financial advisers who focus upon life insurance and would have expected consultation in regard to such a significant recommendation. In the absence of adequate consultation, this recommendation has inappropriately influenced the debate on an issue that could see a further widening in the life insurance underinsurance gap for Australian consumers. We will address this matter in more detail below.

Summary of AFA Position

In our submission we have specifically addressed the recommendations in the Final Report which we believe most directly relate to financial advice. These recommendations including our high level position are set out below:

Summary of AFA Position

No.	Recommendation	AFA Opinion
8	**Direct borrowing by superannuation funds** *Remove the exception to the general prohibition on direct borrowing for limited recourse borrowing arrangements by superannuation funds.*	We support other controls to manage this risk
9	**Objectives of the superannuation system** *Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term.*	Agree
10	**Improving efficiency during accumulation** *Introduce a formal competitive process to allocate new default fund members to MySuper products, unless a review by 2020 concludes that the Stronger Super reforms have been effective in significantly improving competition and efficiency in the superannuation system.*	Oppose
11	**The retirement phase of superannuation** *Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed.*	Oppose
12	**Choice of fund** *Provide all employees with the ability to choose the fund into which their Superannuation Guarantee contributions are paid.*	Agree
13	**Governance of superannuation funds** *Mandate a majority of independent directors on the board of corporate trustees of public offer superannuation funds, including an independent chair; align the director penalty regime with managed investment schemes; and strengthen the conflict of interest requirements.*	Agree
21	**Strengthen product issuer and distributor accountability** *Introduce a targeted and principles-based product design and distribution obligation.*	Agree
22	**Introduce product intervention power** *Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.*	Agree
24	**Align the interests of financial firms and consumers** *Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.*	Agree with the intention however oppose the specific life insurance commission recommendation
25	**Raise the competency of advisers** *Raise the competency of financial advice providers and introduce an enhanced register of advisers.*	Agree
29	**Strengthening the Australian Securities and Investments Commission's funding and powers** *Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.*	Agree

No.	Recommendation	AFA Opinion
31	**Compliance costs and policy processes** *Increase the time available for industry to implement complex regulatory change.* *Conduct post-implementation reviews of major regulatory changes more frequently.*	Agree
37	**Superannuation member engagement** *Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments Commission (ASIC) regulatory guidance.* *Facilitate access to consolidated superannuation information from the Australian Taxation Office to use with ASIC's and superannuation funds' retirement income projection calculators.*	Partial Support
40	**Provision of financial advice and mortgage broking** *Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.*	Partial Support
41	**Unclaimed monies** *Define bank accounts and life insurance policies as unclaimed monies only if they are inactive for seven years.*	Agree

Detailed Response to the Final Report Recommendations

8. Direct Borrowing by Superannuation Funds

The AFA recommends requiring SMSF trustees to obtain licensed financial advice before they can enter into a limited recourse borrowing arrangement (LRBA) within the fund and limit access to regulated loan providers only.

The AFA does not support personal guarantees for LRBAs and would like to see this banned.

We appreciate the concern that LRBA debt within Self Managed Superannuation Funds (SMSF's) has been growing rapidly and may not be entirely consistent with the commonly accepted purpose of superannuation. We are in fact more concerned with mounting evidence that poor practices are emerging creating issues of inappropriate establishment of SMSFs, illiquidity, over-gearing and poor trustee decision making.

Of greatest concern are examples where uninformed people are taking on the role of trustee of a SMSF for the purpose of gearing into property without sufficient understanding of their legal obligations and the risks associated. It appears they are doing this without the benefit of receiving appropriate, authorised financial advice.

It is our suggestion that SMSF trustees should be required to obtain advice from an appropriately licensed financial adviser before they can enter into a limited recourse borrowing arrangement within the fund. This advice would need to clearly explain the risks of the strategy and also model the outcome of the investment strategy including sensitivity to a change in interest rates. Particular focus on liquidity of the SMSF is also required, highlighting outcomes from a reduction in SGC and/or other contributions to the fund from its members (such as occurs in cases of unemployment or hardship when self-employed).

Due to the level of concern about SMSF utilisation of debt funding, we believe that it is necessary to

limit the source of funding for LRBA arrangements to regulated providers of loans. We specifically propose a ban on related party loans, where a breach of the obligations is much more likely. This, in combination with an obligation on the trustees to obtain advice prior to any LRBA being put in place, will serve to ensure that any borrowing arrangements better reflect the needs of the members and the risks of leverage. This will also reduce the likely impact on the members of the property selling tactics that have contributed to the current issue.

We do not support the application of personal guarantees from members of the SMSF as part of the establishment of an LRBA and would suggest that measures are introduced to specifically prevent personal guarantees. This might mean that lenders would be likely to reduce loan-to-valuation ratios, however this is an acceptable (and perhaps desirable) outcome in ensuring the original intent of LRBA's that the only recourse action can be with respect to the asset that the loan is related to.

9. Objectives of the Superannuation System

We support measures that will promote stability in the superannuation system so as to increase confidence and participation by more Australians. Legislated objectives and controls with respect to policy changes will contribute to the achievement of stability and confidence.

The AFA supports the primary objective of the superannuation system as proposed – "To provide income in retirement to substitute or supplement the Age Pension".

A lack of stability in Superannuation policy settings over a number of years has significantly impacted upon consumer confidence in the overall superannuation system. The feedback that we receive from our members during any period of public debate on superannuation changes reveals deep implications for the willingness of their clients to voluntarily participate in the super system. Given that reliance for an individual on only the compulsory participation in superannuation (SGC) is unlikely to fully fund their retirement, it is essential that the system adequately entices voluntary contributions as well. Instability in government policy works against this.

There are significant economic and investment benefits for Australia driven by retirement adequacy outcomes and it is well documented that we are quite some way off achieving this for the majority of Australians. Attracting them to voluntarily participate in superannuation is thus a desirable outcome which is difficult to achieve whilst scepticism and mistrust exists over the willingness of successive governments to meddle in the rules to achieve short term budget/fiscal outcomes.

The AFA supports proposals with respect to progressing this objective including consideration of a joint parliamentary inquiry.

10. Improving Efficiency During Accumulation

The AFA does not support a process to allocate new default fund members to MySuper products. This proposal would break the nexus between employers and an employee's superannuation arrangements, which would lead to a significant reduction in the support and services provided to employee members.

Whilst we recognise the critical importance of fees in influencing the final benefit of superannuation members, it is important to avoid neglecting other key elements of superannuation arrangements. A

simplistic focus on fund investment and administration costs alone runs the very real risk of dispensing with other key benefits that members value throughout their membership of a fund.

Historically default superannuation has been established at the workplace level. This enables a superannuation plan to be tailored to the specific circumstances of the workplace. As an example, this may allow the life insurance arrangements for members of the superannuation fund to be put in place at a significantly better price when compared to other alternatives. In addition, having access to workplace financial education through a corporate super specialist means that members have a qualified resource to call on and will be supported should they need to make an insurance claim.

Allocating new default fund members to MySuper products will discourage employers from paying for additional benefits above the superannuation guarantee minimum, such as insurance premiums and administration fees. They will not pay for a benefit when they have no control over the cost.

Workplace sessions on financial literacy are an essential vehicle to introduce employees to one of the most important skills in life. Many employers arrange this type of program through the utilisation of the services of a corporate superannuation specialist. This provides the benefit of employees developing a sound understanding of their superannuation fund and the investment options available, as well as an understanding of their life insurance cover.

The proposal of a system based allocation of new employees to a particular fund that wins a tender will mean an excessive focus on cost will eventuate and would involve the Government picking winners on behalf of new employees. Cost savings on administration fees is frequently more than offset by increased insurance costs and the loss of other important benefits and services such as workplace financial education.

MySuper and other initiatives should be allowed to play out in a competitive market place before there is any consideration of such a paternalistic “big brother’ solution as has been proposed in this recommendation.

11. The Retirement Phase

We do not support trustees pre-selecting a comprehensive income product for member’s retirement (CIPR). Such an approach fails to recognise the central importance of financial advice in the lead up to, and at the time of, retirement. It also assumes that the one product could be suitable for all members of the fund despite significant differences in their personal circumstances and attitude to risk. Further, such an approach would remove competition within the marketplace at the time of retirement.

We support the removal of regulatory impediments to developing retirement income products.

We support initiatives to encourage and support Australians to prepare well for retirement. We also support initiatives designed to encourage people to favour income streams over lump sums.

Australians approaching retirement need to take adequate steps to seek financial advice. Consideration should be given to policy options that incentivise Australians approaching retirement to obtain financial advice. This could, for example include tax deductibility for retirement advice for people over the age of 50.

There are a number of key considerations involved with retirement planning advice that includes issues such as social security eligibility, effective tax management and estate planning. The nuances in the advice are significantly affected by age and financial position differences between the retiree and their spouse where applicable. The consequences of ignoring these issues is substantial when considered in the context of the CIPR proposal which might suggest that advice is not required.

Page 119 refers to research about the variability in the quality of financial advice and the level of knowledge about longevity risk amongst advisers. These comments do not warrant seeking a substandard default outcome when the more important issue is the availability of quality advice.

The report talks to two sets of problems: one where too much money is taken as lump sums early in retirement and presumably spent; and the second where retirees are too anxious about their funds and deliberately and excessively reduce their spending/consumption. Access to quality financial advice is a necessary solution for both of these problems. Receiving financial advice supports people to have the confidence to enjoy their retirement, knowing that they have adequate funds or an alternative plan, should that be required.

We do not support the automatic preference for products that provide greater longevity risk protection. Whilst we support the availability of annuity products that provide a guaranteed income, we do not necessarily believe that this should be as a direct preference over account based pensions. It is our view that the selection of a retirement income product should be on the basis of the client's needs and objectives, not a preconceived view of one product type over another.

A perceived over-control by government of a retirees superannuation also increases the risk that Australians will not voluntarily participate in the superannuation system thus restricting the likelihood that they will achieve a fully self-funded retirement and a reduction in reliance on government funded retirement.

Health and individual likelihood of longevity are also key issues where someone with a family history and a medical record that suggests the likelihood of a shorter longevity may not be likely to benefit from acquiring a lifetime annuity.

It is essential that the system encourages consumers to both save for retirement, but also to continue to manage for maximised ongoing income in retirement.

Retirement Income Product Development

We support changes to legislation to better enable the introduction of a deferred lifetime annuity into the Australian marketplace. We are less supportive of pooling based products as there could be a high variability in consumer outcomes and this would not be good for public confidence in the retirement incomes system.

12. Choice of Fund

The AFA supports full Choice of Fund for all employees and to the extent that this can be achieved by changes to the Superannuation Guarantee (Administration) Act 1992, or state government provisions, then we would fully support this.

We believe that it is important for individuals to be able to choose the fund that they wish to use, and also for employers to have the flexibility to choose a fund that best suits their employees. We therefore support the proposal with respect to removing restrictions within the Superannuation Guarantee (Administration) Act 1992 which apply to enterprise agreements, workplace determinations and some awards.

We note the limitations that the Federal Government faces with respect to State Government agreements and awards, however we would support steps being taken to address this matter through inter government or multi government forums.

13. Governance of Superannuation Funds

The AFA supports the proposals with respect to director independence and penalty regimes.

Since the introduction of the SGC in the early 1990's and through the progressive increases in the SGC rate, a number of public offer superannuation funds have grown to become very large financial entities. This growth can be expected to continue through the ongoing effect of the SGC and the legislated further increases. The scale of these entities and the number of members involved highlights the need to apply best practice Corporate Governance arrangements. The ASX Corporate Governance Principles are widely regarded as best practice in the Australian environment and should therefore be used as the starting point for Australian public offer superannuation funds.

Accordingly we support the recommendations with respect to the requirement for an independent chairman and a majority of independent directors. We do not accept that there is any supportable argument with respect to why this would not be in the best interests of members. Further, we believe that the introduction of this change should not lead to an increase in the size of these boards, which should also be based upon best practice.

We also support the proposal with respect to the application of criminal and civil penalty provisions consistent with the penalties that apply to the directors of responsible entities of MISs under the Corporations Act.

We strongly support the application of rigorous procedures around conflicts of interest, which are likely to be as relevant and important in the public offer superannuation space as they are in the listed corporate space. We are uncertain as to whether the recommendation with respect to each director signing off on each other director's identified conflicts of interest might be the most efficient way to address this important issue. To some extent this is a matter of principles, practices and disclosure. Having the right culture and processes with respect to the management of conflicts of interest is equally important.

21. Strengthen Product Issuer and Distributor Accountability

The AFA supports the introduction of targeted and principles-based product design and distribution obligations.

Over the last 10 years there have been a number of cases of financial product collapses which have resulted in significant losses by consumers. These collapses have in large part been the result of issues in the product design.

Unfortunately, the blame for these collapses has often been inappropriately directed at financial advisers on the grounds of the remuneration that they received for advising clients to invest in the product. These statements continue to be played out in the media as comments are made about cases like Westpoint, Basis Capital, Opus Prime (none of which were financial advice matters), Trio (fraud) and Agri-business schemes (product design failure). The assumption appears to be that the financial adviser should have known that the products were unsuitable or at risk of failure, however this is typically not the case. It is also the fact that many advisers lost their own money in some of these products, such as the agri-business schemes, indicating their own belief that the products were suitable.

For this reason we support the introduction of a new regime that places greater obligations on the

manufacturers of products to ensure that they are suitable for the target market.

We support the following:

- Deliberate consideration of the target and non-target market for the product.
- Consumer testing of the product.
- Determination of appropriate distribution channels and documented distribution approach.
- Periodic review of the appropriateness of the product for its intended purpose.

We are conscious that there is a big distinction between products that are standard, such as banking or even regular fixed interest or equity type managed investments, when compared with more non-standard products (such as was the case with agribusiness schemes). For this reason the requirements should expand as the level of product complexity and risk increases.

We note the comment in the second last paragraph on page 199 – "Many consumers do not seek advice, and those who do may receive poor-quality advice". We do not see the purpose of statements like this, which in our view do not fairly represent the true situation. It is a concern that the committee held views of this nature that may have inappropriately influenced their consideration of other recommendations. A statement of this nature could easily be made with respect to professions such as medicine, law, dentistry or accounting, however to the extent that the problem relates to a small minority it does not deliver a benefit to the community to make statements that might imply this poor advice as an expected outcome.

In the next paragraph, the statement that "such issues (*what issues?*) have contributed to consumer detriment", seems to imply that financial advice is the cause of consumer detriment. This is clearly not a factor with Opes-Prime and not a major factor with Westpoint, agribusiness schemes or unlisted debentures. The apparent suggestion that all advice with respect to products that fail must be inappropriate is simply false. The assessment of the appropriateness of the advice is made at the time the advice was provided with the benefit of the knowledge at that time, not with the benefit of hindsight.

22. Introduce Product Intervention Power

The AFA cautiously supports the proposals with respect to product intervention powers.

We note the positioning of this measure as a power that should be used as a last resort or pre-emptive measure where there is a risk of significant detriment to a class of consumers. We also note that ASIC would need to have a very firm basis to make a move of this nature given the significant commercial consequences and that it would be subject to judicial review.

We support this proposal, however we note that it sounds good in principle, however will be much more difficult in practice. In this regard, we make the following comments:

- This places significant obligations on the regulator and it may also create unrealistic expectations.
- It is necessary to ensure that this does not create a moral hazard, in that consumers will form the view that ASIC will prevent them from experiencing consumer detriment.
- The distinction between protecting new investors versus protecting existing investors can often result in very different actions and outcomes. Regulator intervention against an open product may result in increased losses for existing investors, when compared to leaving the product open. This does not imply allowing more new investors into the product if it was apparent that

they would be facing a high probability of loss, however the differing impact upon existing and new investors is a factor that would need to be considered.

- Defining the threshold point for intervention will be challenging across different potential scenarios and product types/distribution channels.

It is important to be very considered about how this power might play out and how realistic it is to expect this measure to circumvent a financial collapse or prevent major consumer detriment. If we look at one of the examples referred to in the FSI report, it might highlight that what appears possible in hindsight may not be realistic in practice.

During the GFC a number of mortgage and property funds were frozen, impacting many clients. This all arose shortly after the announcement of the Government Guarantee on bank deposits. The establishment of that guarantee by the Government had an immediate impact on investment decisions and placed products like mortgage and property funds at a significant competitive disadvantage. Investors sought to withdraw from the mortgage and property funds to invest in term deposits with the benefit of the government guarantee. The outflow of capital from the mortgage and property funds created a "run on the bank" type of outcome and those funds froze investors from being able to withdraw their money so as to not collapse the funds. This has had effects on individual investors access to their money for nearly six years with some funds still unwinding their positions.

The events of 2008, following the collapse of Leehman Brothers were exceptional. In any case, how would it have been possible in the timeframe immediately prior to the freezing of these funds for ASIC to have taken action to protect the interests of existing investors? It would be unrealistic for ASIC to have acted in the timeframe available. We use this example to highlight the challenges in implementing Recommendation 22.

There will need to be a lot of work done to work out exactly how this power would be employed, what procedures the regulator would need to follow prior to intervention and how ASIC might then continue to support an entity that had been the subject of the application of these powers.

We support the further investigation of this power and a deeper examination of effective use of similar powers in foreign jurisdictions. This will take some time to fully develop and to ensure that the appropriate controls exist to ensure that the benefits exceed any unintended consequences.

24. Align the Interests of Financial Advisers and Consumers

The AFA strongly opposes the recommendation with respect to life insurance commissions.

We support the proposals with respect to providing ASIC with power to ban people from managing a financial firm.

We note the FSI recommendation with respect to life insurance commissions and the reference to the industry working group that was established to address the significant issues raised in ASIC Report 413 - Review of Retail Life Insurance Advice, as released on 8 October 2014

The AFA fully appreciated the significance of ASIC Report 413 when it was released last year. In our opinion it was essential that the life insurance industry and the financial advice profession collectively review the issues and then identify, in a unified sense, the changes that would be necessary to overcome the core underlying issues in Report 413.

In jointly initiating the process with the Financial Services Council, we genuinely believed that it was possible to reach agreement on the remuneration changes and other improvements that would present a solution for the issues. The Life Insurance and Advice Working Group (LIAWG) was formed and John Trowbridge was appointed as the Independent Chairman. Through this mechanism, John

was given the mandate to form his own views on the best solution for the Life Insurance industry and issue a report of those findings – the "Trowbridge Report".

In seeking a solution, the AFA's key underlying principles are as follows:

- The outcome must be in the overall best interests of consumers of life insurance advice and life insurance products.
- We must ensure that clients continue to have ready access to advised life insurance, and that any changes that significantly impact the financial viability of life insurance advice will, as a result, reduce consumer access to life insurance financial advice.
- The solution must work to protect the existence of the independent (non-vertically aligned) financial advice marketplace, which enables consumers to continue to have the choice to access advice that is not aligned to product providers.
- The selected model must be simple to implement so that any savings in costs can be readily passed on to consumers in the form of reduced premiums rather than being directed towards increased administration and system costs within the industry.
- The distinct advantages of advised life insurance contribute to the public good and need to be maintained. These include more appropriate levels of insurance, better quality policy wordings, cheaper premiums than direct or group insurance, and underwriting at the time of the policy being initiated, creating far greater certainty at claim time.

The FSI report, with the recommendation for level commissions had a significant impact upon the LIAWG as some members of the working group argued that it was the FSI report that set the benchmark for what the community expected. For the reasons set out below, we believe that it was quite unfortunate that the FSI made the recommendation that it did, during the LIAWG process and without adequate consultation with the industry on the issue. The Trowbridge Report, released on 26 March 2015, made the following recommendations with respect to remuneration:

- Following a 3-year transition period, the Reform Model will be implemented which means:
  - Level commissions at 20%.
  - An Initial Advice Payment (IAP) to be paid by the insurer to the adviser based on a per client basis.
  - The IAP is a maximum of $1,200, or where premiums are less than $2,000, no more than 60% of the first year's premium.
  - The IAP is to apply no more often than once every five years (the "five year rule").
  - Clawbacks remain at 12 months on the initial 20% commission and the IAP.
- Licensee benefits from life insurers be modified to reflect the ban that is now applied to investment and superannuation business.

In our assessment of the Trowbridge Reform Model, our concerns relating back to our principles are as follows:

- Whilst these changes will result in a significant reduction in remuneration for financial advisers, there is no commitment, recommendation or accountability with respect to the passing on of these insurer cost savings to consumers of life insurance by way of lower premiums.
- The significant deferral and overall reduction in remuneration for financial advisers will result in a large number of advisers either starting to charge clients an additional fee for the advice, which will increase the cost of life insurance, or alternatively the advisers will stop providing life insurance advice or leave the market and consequently reduce access to life insurance advice which is clearly superior to other insurance alternatives.
- The reduction in payments to licensees, and the reduction in the number of advisers, will cause a significant reduction in the viability of independent licensees. This will lead to further

consolidation and concentration of the financial advice market and make it more difficult for clients to get non-vertically integrated, independent financial advice.

- The payment of a fixed dollar initial advice payment on a *per client basis* will necessitate significant system development by life insurers or other parties involved in the model. It will be extremely complex, in the context of a client implementing insurance arrangements through different life insurers, where there will be different premium levels and timings for the finalisation of the new policies. To us it seems that the benefit gained by this per client flat dollar model will not exceed the cost (conceivably in the hundreds of millions of dollars) involved in building the solution and would also defer any reduction in premiums for consumers for many years to come.

We believe that the Trowbridge review has been a healthy exercise for the industry in accepting accountability to confront the issues and that it is an appropriate pathway to find a sensible solution. We remain hopeful of presenting a unified solution to ASIC and the Government in the weeks to come.

We firmly believe that High Up-front Commission rates of over 100% are no longer viable in the modern life insurance context. We recognised the need for change and we have warmly embraced this exercise. Our position is that High Upfront Commissions should be banned and that initial commissions should be limited to no more than the current Hybrid option which pays 80% (plus GST) in year one and 20% (plus GST) on an ongoing basis.

The FSI has effectively recommended legislating level commission terms with the rate to be set by the market and industry. This recommendation appears to be a late inclusion, possibly in response to ASIC Report 413. We were most surprised to see this recommendation as despite being consulted on a range of other FSI matters, this proposal was never discussed with us.

In assessing the FSI recommendation it is necessary to consider some of the relevant factors in the provision of financial advice:

- The cost of providing life insurance advice is estimated to be in the range of $1,500 - $3,500.
- The average premium per life insured is in the range of $3,000 to $3,500.
- If we take the example of a $3,000 premium and a level commission in the range of what has been proposed by John Trowbridge of 20%, then the adviser would be paid $600 to provide advice and implementation services that cost at least $1,500. Even on the current standard level commission rate of 30%, the adviser would be in a loss position in year one of at least $600.
- The fees paid to a financial adviser need to cover their costs of servicing and reviewing clients and also the extensive services provided to those clients who experience a claims event. Thus on these terms, it is many years, if at all, before an adviser would reach a breakeven position. If an adviser charges the client a bespoke fee to cover the advice costs, then consumer costs will rise thus making insurance less affordable and less likely to be purchased.

The simplest summary of this issue is that businesses will not continue to provide services if they lose money on them. Both the Trowbridge and FSI recommendations on this issue impose that outcome on financial advisers and are therefore detrimental to achieving adequate life insurance across the community and the public good of a reduced reliance on public funding and services when a health crisis occurs.

For the reasons set out above we do not believe that the FSI recommendation is viable for life insurance advice and will have significant detrimental community outcomes. There is likely to be a significant reduction in the number of financial advisers providing life insurance advice. Financial advisers would also need to be more selective with the clients that they work with and it is most likely that clients with premiums of less than $5,000 would no longer be economically viable – this represents the insurance costs applicable to the vast majority of Australian families leaving most unlikely to receive the value of financial advice on their insurance needs.

It is also our view that the FSI has failed to take into account overseas experience where changes have been made to life insurance remuneration arrangements and have then resulted in a reduction of life insurance.

There have been many claims in the media about the extent of the so called “churn” issue. “Churn” is a word that should only be used to describe inappropriate product replacement where there is no net material consumer benefit when changing policies. This is conduct that is in breach of the best interests duty and the obligation to prioritise the interests of the client. This type of advice needs to be distinguished from appropriate product replacement advice where there is a genuine consumer benefit.

Genuine appropriate product replacement advice should not be discouraged when it is in the client’s best interests and it should not be confused with “Churn”. The Trowbridge report has referred to the issue of a product replacement problem, however neither the FSI nor the Trowbridge report have quantified this issue. Life insurers already have the capacity to identify it, and prevent it, and to the extent that they have chosen not to perhaps is the clearest indication that the size of the problem does not warrant the attention that it is receiving.

As indicated earlier, advised life insurance is significantly better than direct insurance for the following reasons:

- Advice specific to the client’s circumstances is included. This means that advised clients are going to get the level of cover that they need and can afford. On average, non-advised clients only have one third of the level of cover as advised clients and the averages for both still remain below the level considered to be adequate in studies such as that completes in 2008 by KPMG with the FSC.
- The cost of advised life insurance is up to 40% cheaper than direct. The risk for advised clients is better understood by the life insurer so the pricing can be more competitive.
- The terms of the cover (events that will be paid out) are more comprehensive with advised business and cannot be changed by the insurer.
- The underwriting occurs prior to the cover being placed, which means that there is substantially greater certainty that claims will be paid. Direct insurance is usually underwritten at the time of claim and many claims are rejected leaving consumers disbelieving in the value of life insurance.

Underinsurance with respect to life insurance remains a problem in Australia. In 2011 Rice Warner estimated it to be $3.1 Trillion. Most people rely upon their superannuation fund for insurance and in many cases they have the default level of cover which is usually significantly less than they would need in the event of a health crisis or death. There is a low level of appreciation of the need for insurance.

Consumers often do not understand what they are insuring and what needs will be addressed through an insurance claim. People often don’t appreciate that their future employment and income is an asset that should be insured. Whilst the concept of a payout on death is reasonably clear, when it comes to TPD, trauma or income protection the clarity of the circumstances under which a benefit is payable is much less understood.

Life insurance contracts are complex and it is important that consumers understand what they are purchasing. In most cases access to financial advice adds significant value to ensure that the terms of the policy reflect the client’s needs, and ensures that the client has a clear understanding of what is covered and what is not.

The AFA supports additional powers for ASIC to ban managers of financial services businesses, where they might be people who have previously been banned as providers of financial services or have previously been involved in the management of other financial services firms that had committed significant breaches of their obligations. We support the introduction of these additional powers as

they will work to ensure that people with poor ethics or who have contributed to consumer detriment can be kept out of the industry. This is in the best interests of all stakeholders in the financial services industry.

25. Raise the Competency of Advisers

The AFA supports the proposals with respect to increasing the competency standards for financial advisers, however notes that the Parliamentary Joint Committee on Corporations and Financial Services has subsequent to the release of the FSI put forward a more comprehensive framework.

There is broad recognition and support for the need to increase the education standards within the financial advice profession both at the entry and ongoing practitioner levels. There is a virtually universal view that as a profession, the minimum education standard for new advisers should include a relevant university degree. The AFA supports the goal of a relevant university degree as the entry criteria for new financial advisers entering the financial advice profession however we believe that this goal needs to be introduced over a sensible timeframe.

In our previous submission to the FSI we have put forward our views on why this transition needs to be measured, including the following:

- The education marketplace for financial advice degrees is currently immature. Some courses exist, however they are not well supported and typically the entry level is reasonably low. There simply isn't currently a high level of demand or throughput for financial advice degrees.
- Whilst life experience isn't mandatory for someone operating in the financial advice profession, it is often considered by clients to be desirable as it better enables an adviser to have the empathy, understanding and emotional intelligence integral to helping clients develop new behaviours to improve their financial position.
- The current adviser market place is skewed with a number of older advisers who are expected to leave the profession over the next few years before a sufficient supply of University graduates will be qualified.

As baby boomers approach retirement in increasing numbers over the next few years, there is no question that we need to ensure that there is an adequate number of competent financial advisers to meet this demand for financial advice. It will be critical to ensure that we have an adequate volume of new advisers entering the profession as existing advisers depart. Thus, any fundamental change to the education standards, needs to be done in a manner where transition arrangements will ensure that clients can still access the financial advice that they so clearly need within the timeframe that is relevant to their life stage.

We strongly believe that financial advice education needs to contain a balance of technical training and also emotional intelligence training. Client relationship skills are essential in financial advice. Financial advisers who have strong technical skills, but poor client relationship skills struggle and don't succeed in providing the emotional outcomes like peace of mind, confidence and security. These are things that clients really value in their relationship with a financial adviser and have been proven through client research. Ensuring these skills are attained before being fully licensed to provide personal financial advice is essential. This is why we also support the concept of a professional year being required of all new advisers.

It is important to remember that much of the benefit from financial advice comes from the client successfully adopting better money-related behaviours and it is the relationship and coaching element

within an advice relationship that creates the environment for this to happen and be maintained. It takes unique skills to create behavioural change with clients.

The current entry-level requirement, known as RG 146, is basically at diploma level, although the existence of some less strenuous versions of this course has led to much media discussion about the qualification being gained too easily. This does not reflect the vast majority of the marketplace, however this emphasises the fact that the minimum level needs to be raised significantly and the delivery needs to gain a level of standardisation to ensure that the requirements are equally applied. We believe that action on this front can be taken in the short term.

It is our experience that education standards on their own will not achieve the outcomes intended. Cultural change, as proven through behaviour, is the ultimate goal and professional association membership, peer-to-peer learning experiences and practical training and supervision are needed to be successful.

Education Requirements for New Advisers

The AFA supports the following requirements for new advisers:

- Completion of a relevant degree,
- Completion of a professional year program,
- Completion of a registration exam.

Financial advice over the years has benefited from the career transition of a number of different groups who already possess skills that are beneficial for someone in a role providing financial advice. This could include people from a teaching, engineering or management background. In addition, there are also likely to be people who complete what might loosely be defined as a relevant degree who do not obtain, through their degree course, all the necessary prerequisite education requirements. For this reason we believe that consideration needs to be given to bridging courses for people with other degrees, who may offer strong skills and the potential to be a great financial adviser.

Education Requirement for Existing Advisers

We note that neither the FSI nor the PJC report addressed in specific detail what the transition or grandfathering requirements should be for existing financial advisers. It is important to note that a reasonably high proportion of recent new entrants to financial advice are already degree qualified. Overall, however, our own surveys suggest that the proportion of financial advisers with a degree is likely to be less than 25% and this is not based upon the tighter definition of “relevant” degree.

The AFA does not believe that it is practical to expect all existing advisers to be required to obtain a relevant degree. This would have a phenomenal impact upon the number of advisers in the marketplace if those unwilling to seek a degree left the market resulting in significantly less consumer access to financial advice. Sensible grandfathering and pragmatic transition arrangements are essential.

The AFA does support an increase in the education standard for existing advisers. A number of large licensees have established business requirements that existing advisers need to achieve the standard of the professional designation of one of the two leading associations (FChFP and CFP) or the completion of a Masters of Financial Planning. We support this commitment to improving the education standard of the advisers in these licensees. We also appreciate that a standard needs to be developed for all existing advisers that delivers a meaningful increase in the current minimum education standard.

The current education pathway for financial advisers commences with the completion of the Diploma of Financial Planning, which is basically the minimum standard. Beyond this the next step is typically

to complete the Advanced Diploma of Financial Planning which involves an additional four subjects. As an interim step we believe that mandating the requirement to complete the Advanced Diploma of Financial Planning should be introduced as a requirement for existing advisers.

29. Strengthen the Australian Securities and Investment Commission's Funding and Powers

The AFA believes that it is sensible to transition towards a user pays model of funding for ASIC. We also believe that the penalty regime should reflect international standards and serve to provide a strong disincentive for doing the wrong thing.

It is sensible to support the idea that ASIC should be funded on the basis of a user pays basis, however we would like to make the following points:

- Any transition to full industry user pays funding model should be completed on a progressive basis to ensure that the impact upon the industry in any one year is not excessive.
- Dynamic funding based upon the perceived level of supervision, would need to be managed carefully, as this presents the risk of being somewhat arbitrary and also problematic when considered in the context of how fees might reduce over time to reflect an improved regulation/supervision environment.
- The fees should be proportional to the scale of an entity.

At present financial advice licensees are charged for AFSL license applications and for AFSL annual returns. Licensees also pay fees for the registration of financial advisers on the registers. We agree that the current fee arrangements do not necessarily reflect the scale of entities, particularly at the licensee level, where there is no differentiation in the fees paid by corporate entities between very small and very large licensees.

We also support the proposal with respect to longer term funding commitments to ensure that ASIC is not put under funding pressure in economically difficult times when the need for supervision and oversight may be greater.

With respect to penalties, our view is as follows:

- Penalties for significant wrong doing should be sufficient and should represent a sizable deterrent from such activity.
- If the penalty is to be treated as income for ASIC, then it should not be of a scale that would cause an inappropriate incentive for ASIC.

The FSI report does not state the level of penalties that are proposed so it is difficult to provide a more definitive response, however the concept of a significant deterrent is supported.

31. Compliance Cost and Policy Process

The AFA believes that it is essential to provide business with at least 12 months lead time before significant regulatory changes take effect. We also believe in rigorous regulatory impact assessment and post implementation reviews.

We recognise the need for change in the financial advice space and do not believe that we can use the volume of reform as an excuse to avoid change. Having the necessary timeframe to implement change is, however critical.

In recent times the financial advice profession and the financial services industry have implemented the FoFA changes and also commenced the TASA regime. We now face major changes to the life insurance market (including remuneration arrangements) and to the education requirements for financial advisers. From the outside this may seem reasonable and digestible. In reality the actual position is different. In financial advice we had the introduction of FoFA, and then the FoFA Amendments, with the FoFA Amendments Regulations then defeated in the Senate last November, which has resulted in some of the measures that were expected to be repealed now becoming effective again. It is challenging for licensees to stay on top of what is required of them and then to actually ensure that they have met all these additional obligations by the imposed implementation dates. The Opt-in Obligation is a classic case in point:

- Opt-in is the obligation for financial advisers to have their clients re-commit to their arrangement every two years.
- It was part of the draft legislation as released in August 2011.
- In March 2012, a potential exemption was introduced where a financial adviser was bound by an ASIC approved Code of Conduct that obviated the need for Opt-in.
- In December 2013 the new Government announced plans to repeal the Opt-in obligation.
- In March 2014 the government introduced legislation that would repeal Opt-in
- In July 2014 the Government introduced a regulation to provide an 18 month exemption from Opt-in
- In November 2014 the regulation that provided an 18 month exemption was disallowed.
- At present the legislation that includes the repeal of the Opt-in obligation, having passed in the House of Representatives, sits on the books in the Senate.
- The Opt-in obligation is due to commence on 1 July 2015, however there is still a high level of uncertainty and there are no ASIC approved codes that enable the March 2012 exemption.

The points above are intended to illustrate the difficulty for business in trying to comply with obligations that are subject to uncertainty and where additional cost might be incurred in trying to deliver regulatory change solutions in a quick timeframe and an uncertain environment.

We strongly believe that industry needs at least 12 months from the date legislation has been finalised before it comes into effect and that where changes to existing legislation are proposed that there should also be a greater level of lead time before obligations commence.

We also make the point that any significant regulatory changes that have deep structural implications or require business model modification, such as major remuneration changes for financial advisers needs additional time to ensure that change can be achieved in a manner where business viability can be preserved.

Every major change should only commence on the basis of a comprehensive regulatory impact assessment. Post implementation reviews are also essential to ensure that national or consumer benefits that were targeted in the change are actually achieved.

37. Superannuation Member Engagement

The AFA has limited support for this proposal as we don't believe that member statements will drive member engagement and question the potential implications of greater access to consumer data.

Whilst we do not oppose the addition of retirement income projections, we note that the impact is likely to be limited in terms of member engagement. Improved member engagement will come from other activities including access to face to face advice and workplace education arrangements. We also question the effectiveness of seeking to explain issues like sequencing risk through the use of member statements.

Specifically with respect to retirement projections, care needs to be taken that projections do not create an unintended optimism that ignores sequencing risk. Without adequate understanding of the implications of the projections, they may do more harm than good.

We would recommend that research is undertaken to understand the proportion of people who pay close attention to things like superannuation statements and fee disclosure statements. We expect that it is a relatively small percentage of the population and probably most likely to be those who already have a good level of financial literacy. Through our research we have found that people are reluctant to ask questions where it is likely to reveal a low level of financial literacy and therefore there are some real obstacles that need to be overcome before the full benefits of member engagement can start to be addressed.

We are quite hesitant about providing access to the ATO data on other superannuation holdings as this data may be used for the wrong purposes. It is appropriate for superannuation funds to encourage members to consolidate their super, however this should be done very carefully as clients may unintentionally be giving up valuable insurance cover when they close an existing superannuation fund. In this case if the member were to have experienced an insured event then they will miss out on the claim and have no one to seek compensation from

40. Provision of Financial Advice and Mortgage Broking

The AFA has limited support for the proposal with respect to changing the term general advice. We believe that there is a need to review the general advice option to ensure that the management of the boundary between high obligation personal advice and low obligation general advice is clearer.

We note that the PJC has also made a recommendation with respect to "general advice".

We appreciate the focus in recent times on the appropriateness of the term "general advice" and the concern that this may be misunderstood by consumers. It seems that this debate has not always understood all the circumstances in which the term general advice applies.

Certainly general advice applies in the context of the conduct in call centres and branches, where a specific product is being discussed. General advice also occurs when a financial adviser is presenting to a group and discussing issues like maximising concessional contributions caps (salary sacrificing), or explaining the risk characteristics of different asset classes and their suitability to clients with different risk tolerances. This may also be the case when an adviser is having an initial meeting with a client. In these cases it is unlikely that a specific product is being mentioned. It is this financial

adviser form of general advice that is truly general advice and for which the current tag remains appropriate.

We are also cautious as to the impact of a change in the term as the term "general advice" is what the provider understands. It is not something that is used frequently in the course of discussions with clients. For this reason the impact of such a change may not be as great as expected.

Within the financial advice landscape, there is a huge divide between general advice and personal advice. The obligations in the provision of personal advice are much higher, although many consumers would be unaware of the different standards that apply to the adviser in the respective situations.

Where personal advice is provided, the financial adviser has the obligation to follow the full financial advice process, to comply with the Best Interests Duty and related obligations and to provide a statement of advice.

The obligations are much less when general advice is provided.

For this reason there is heightened risk and exposure for clients when businesses operate on the border of general and personal advice. The trigger for personal advice rules to apply is where the advice provider relies upon the client's personal circumstances in the provision of the advice.

We believe that there is a need to review the general advice option in a context much broader than just the term used in order to ensure that the management of the boundary between high obligation personal advice and low obligation general advice is clearer and that consumers are better protected. When it comes to call centres and internet based businesses that can facilitate financial transactions on behalf of clients through the use of general advice, there is a need to look very closely at this and to ask questions about whether this business model is in alignment with meeting the needs of the consumer.

The important outcome here is that the client does not mistakenly act on general advice under an assumption that the advice purports to take their personal circumstances into account. Improved financial literacy will play a big part here. We also think that there needs to be consideration of additional plain English disclosure documents provided to clients where any general advice involves the recommendation of a specific product.

At the same time, we believe that it is necessary to examine further options for making it more cost effective to provide personal financial advice that is directed to a specific need of the client. This is known as scaled or scoped advice. The provision of scaled advice remains unnecessarily complex.

41. Unclaimed Monies

The AFA supports the recommendation with respect to unclaimed money, noting that this is something that the government has already announced it will proceed with.

We strongly support increasing the timeframe back to the original seven year period. In our opinion this reduction in the timeframe was never in the benefit of consumers as three years is simply too short a timeframe to form the conclusion that the money was unclaimed. It also opened up the consumer to losses as a result of being removed from the product and in the significant difficulty in recovering these so called "unclaimed monies".

We support the Governments moves to quickly address this issue.

We believe that this particular issue is a strong example in favour of Recommendation 31. This particular initiative was strongly opposed by the financial services industry at the time and was

introduced far too quickly and at significant cost to the industry. The benefit to the country was confused by the practice that was introduced through the mechanism of including the collection of these unclaimed monies in Consolidated Revenue. There was no benefit to the community or to consumers in this measure and it has simply caused a lot of expenditure, confusion and wasted effort.

Conclusion

We thank you for the opportunity to provide feedback on the FSI Recommendations.

Should you have any questions, please do not hesitate to contact me on 02 - 9267 4003.

Yours sincerely,

Brad Fox

Chief Executive Officer