

financial services newsletter

Regulation and Compliance

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Superannuation choice – can financial advisers get it right?

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On 6 April 2006, the Australian Securities and Investments Commission (ASIC) released its *Shadow Shopping Survey on Superannuation Advice – An ASIC Report* (the ASIC Report). The results of the survey have clear implications for financial advisers, compliance managers and Australian financial services (AFS) licensees, not just in relation to superannuation advice, but to the quality of financial advice overall.

The survey was conducted by Roy Morgan Research using real consumers. Its purpose was to assess whether financial advice given to consumers after the introduction of the *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005* (Cth) complied with the law. The survey¹ assessed 306 examples of advice from 259 individual advisers, given between June and December 2005. These advisers represented 102 licensees.

Issues

The survey identified several key areas where the provision of superannuation advice to clients did not meet the requisite standards.

The good news

The survey results reflected some improvements in the quality of advice given by financial advisers over previous surveys. For example, in 73 per cent of cases there was proper disclosure of adviser remuneration. The ASIC Report also noted 'some excellent

examples where the consequences of switching (moving from one superannuation fund to another) were clearly set out'.

Further, where strategic advice was given to participants in addition to a recommendation about which fund to use, it was generally considered of great benefit to the client. ASIC defines strategic advice as including advice on:²

- how much to invest;
- how much insurance cover to hold;
- asset allocation given the client's goals and risk profile;
- tax advantages like salary sacrifice;
- after tax considerations such as social security factors; and
- eligibility for co-contributions and superannuation splitting.

About 23 per cent of the verbal advice cases consisted of a recommendation to stay in the existing fund, some of which could have been phrased as general advice. In addition, this advice was generally reasonable and non-conflicted. ASIC now plans to review the obligation to provide an SoA to a client where an adviser, without a conflict of interest, makes a recommendation to stay in the current fund and the advice is free. The Federal Government's new consultation paper on financial services reform (FSR)³ also raises the possibility of amending the law so that an SoA does not have to be prepared where no financial product is recommended and no remuneration is received.

Table: Areas identified for improvement

Rule	Requirement	Survey result
Know your client	Has the adviser investigated and considered key factual issues, such as the client's personal and financial circumstances including their age, family situation, income and existing superannuation arrangements, before the provision of advice?	In approximately 15 per cent of cases, advisers did not know enough about their client's circumstances or goals prior to making a recommendation.
Reasonable basis for advice	Was the advice appropriate to the client's circumstances and needs?	Advice was given in circumstances where it was not reasonable and did not suit the needs of the client. Advisers were also not adequately researching the key details of funds prior to recommending them.
Analysis where a switch is recommended	In comparing funds, did the adviser exhibit knowledge of the funds' benefits and requirements of both the existing and recommended fund? Advice to switch funds often lacked credible reasons and risked leaving the consumer worse off.	Advice to switch funds often lacked credible reasons and risked leaving the consumer worse off.
Disclosing the consequences of replacing funds	When recommending a change in superannuation fund, all additional requirements in s 947D of the <i>Corporations Act 2001</i> (Cth) must be met.	Advisers failed on some occasions to clearly disclose all charges the client would face and the costs and benefits of the switch.
Statements of Advice (SoA)	Whether the adviser had provided a written SoA where personal advice had been given and whether it contained all necessary information that needed to be disclosed to the client.	In 46 per cent of cases, advisers failed to give an SoA when required by law to do so. However, one-fifth of those cases involved verbal advice to the client to stay in their existing fund and this advice was found to be reasonable and non-conflicted.
Conflict of interest	Conflicts of interest must be identified, assessed and managed, including disclosure to the client where necessary.	Advisers who had an actual conflict of interest and received higher remuneration if the advice was followed, or recommended products associated with the licensee, were found to be three to six times more likely to give unreasonable advice.

Implications for the financial services industry

However, the survey also highlighted numerous areas where improvement is required, six of which are outlined in more detail as follows (see also Table on p 14).

The 'know your client' rule

Under the *Corporations Act*, a financial adviser has legal obligations to only provide personal advice on superannuation funds if they have, among other things:

- made reasonable inquiries about their client's personal circumstances (know your client — s 945A(1)(a)(ii)); and
- considered and investigated the

subject matter of that advice (know your product — s 945A(1)(b)).

The survey highlighted some common breaches of the 'know your client' rule including:⁴

- the provision of advice to a client's spouse or children in circumstances where the adviser had not met them;
- giving advice with complex implications to a new client after only a short discussion;
- a failure to consider whether the client had access to superannuation choice prior to the provision of advice; and
- overlooking any matching of voluntary contributions that may be made by the employer to the client's existing fund, but not in the recommended fund.

Having a reasonable basis for advice

Section 945A(1)(c) of the *Corporations Act* states that a financial adviser must make a recommendation which is appropriate to achieve the client's identified needs and objectives after making reasonable inquiries of those circumstances from the client. This is very relevant to recommendations on superannuation products.

The survey highlighted that some advisers did not have a reasonable basis for their advice, had failed to adequately research both the 'to' and 'from' fund, and had failed to articulate how the recommendation suited the client's needs. Further, in many cases within the survey, the rationale for why the client



should change to a new fund was expressed in 'marketing language' which was either vague or irrelevant to the client's needs and objectives including:

- 'consolidated reporting' — where the client had only one fund;
- 'diversification' — where the existing fund had similar investment options;
- 'flexibility' or 'choice of investments' — without disclosing how this related to the client's needs;
- 'well regarded' fund — a term which has no real meaning without further explanation; and
- 'tax advantages' — when the tax situation was the same regardless of which fund was used.

Analysis where a switch is recommended

Advisers who were the subject of the survey made a recommendation to either switch from one fund to another, or rollover or consolidate numerous funds to a new one, in 124 cases (44 per cent of the advice given). Forty of these either had no reasonable basis or probably did not have a reasonable basis. Such advice was a clear breach of the *Corporations Act*.

This is a surprising finding given many licensees utilise SoA templates that should include a structure for showing the comparative features of existing and new funds using short, objective information on key issues, and an explanation for why the fund is appropriate for the client.

Disclosing the consequences of replacing funds

Under s 947D of the *Corporations Act* financial advisers must ensure, when recommending a change in superannuation fund, that some additional disclosure requirements are met including:⁵

- all charges the client will face;
- all pecuniary and other benefits the client will lose by following the advice, such as insurance cover and the right to a lifetime pension;⁶ and
- any other significant consequences.

Only 24 consumers (20 per cent) who received a recommendation to switch funds during the survey received compliant disclosure about the costs and consequences of that switch.⁷

The most common problems were

the failure to advise about a loss of insurance cover when switching out of a current fund and to address whether replacement insurance was needed. Only 21 per cent of consumers were given advice about life and disability insurance issues.

There were also fewer than 10 cases where the adviser specifically noted that the client should wait until they were accepted for insurance in the new fund before relinquishing the existing insurance in their current fund. This clearly exposes the client to risk, as they will be without insurance if they are refused insurance in the new fund due to ill health or other high risk factors.

SoA — provision to a client and its content

An SoA is generally required where specific superannuation funds are recommended by an adviser to a client. In the survey, in 132 cases the adviser failed to provide an SoA as required. This constitutes a breach of the licence. ASIC believes these cases fell into four broad categories:⁸

- quick advice that should have been phrased as general advice (with a warning that the adviser has not investigated the client's personal circumstances) and which does not require an SoA;
- quick advice that consumers stay in their current fund because it suited their needs;
- personal financial advice given during the initial client interview where the client did not proceed which should have again been expressed as general advice or as issues to be further explored; and
- verbal advice to switch funds where the adviser wanted the client to proceed before the adviser would put anything in writing.

Conflict of interest

The survey found that disclosure of adviser remuneration and conflicts of interest were generally compliant where an SoA was given. However, where the adviser had a conflict of interest due to remuneration (that is, the receipt of trail commissions, salary bonuses on sales or salary level dependent on sales), 28 per cent of the

advice did not have a reasonable basis and another 7 per cent probably did not. Further, advisers were between three to six times more likely to provide non-compliant advice if they recommended a product associated with their licensee.

There is no question that any adviser who recommends a switch to a commission paying fund, a fund with higher fees or an inhouse fund, will be assumed by ASIC to be 'selling' product rather than giving impartial advice (even though it may be appropriate advice). It is imperative therefore that reasons for the switch, why it suits the client's needs, how it benefits them, and the costs and consequences of the switch, must be outlined very clearly if such a recommendation is to be made.

Conclusion

The survey highlighted some improvements in financial advice since the introduction of FSR legislation, including a focus on strategic advice and recognition that verbal hold recommendations are usually reasonable and done to avoid incurring costs by the client rather than for any other purpose. The proposed review of the law in this area is warranted as a result.

However, the implications for the industry continue to be the conflicts of interest associated with the sale of inhouse product, the failure by some advisers to deliver basic competency levels and the need to review the obtaining of information on both the 'to' and 'from' fund.

These matters need to be addressed before the next shadow shopping survey takes place and to ensure that consumers can access appropriate advice in a superannuation choice environment. ●



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Endnotes

1. ASIC 'Survey finds quality of advice on super still needs

improvement' Information Release
06-104 (6 April 2006).

2. ASIC Report, p 11.

3. Federal Treasury of Australia
Corporate and Financial Services

*Regulation Review — Consultation
Paper* (April 2006) 13.

4. Above note 2, p 28.

5. Australian Government *Choice
of Superannuation Fund* —

Information for Professional Advisers
(April 2005).

6. Above, note 1.

7. Above note 1, p 23.

8. Above note 1, p 9.