FINANCIAL SERVICES COUNCIL –SUBMISSION

Introduction

The FSC has chosen to make submissions on only those parts of the Draft Report referred to herein. Those parts are mainly related to the provision of financial advice.

Chapter 7 Dominance through integration?

The FSC agrees with the Productivity Commission's ("**PC**") finding that vertical integration, however defined, is not a problem in and of itself[1] and supports many of its recommendations. With adequate reporting, the right regulatory levers, and regulators using those levers as necessary, the FSC considers that the benefits of vertical integration to consumers should far outweigh the perceived shortcomings.

Definition of "Vertical Integration"

In order to determine whether vertical integration strengthens or inhibits competition in the financial services sector, the term itself should be defined. The FSC considers that "vertical integration" refers to a relationship between suppliers of financial products and services in at least two different stages of production. It is a model that has been adopted throughout the financial services industry, and, as a result of views expressed in the media by regulators and others, has become synonymous with providing product recommendations through financial advice. Such relationships can take many different forms, including:

- issuers entering into contractual arrangements with advice providers for the latter to assist in providing advice concerning the issuers' products. Such arrangements are often entered into by Australian Financial Services Licensees ("**Licensees**"), authorised deposit-taking institutions ("**ADI**") and industry superannuation funds;
- Financial advice Licensees entering into white-labelling arrangements with product issuers;
- ADIs owning both the Licensee who provides the advice, the product issuer and/or the asset manager;
- industry superannuation funds owning the Licensee who provides members with advice; and
- industry superannuation funds developing in-house asset management capabilities.

The Draft Report has taken a very narrow view of vertical integration as it only focusses on ADIs owning advice Licensees. The FSC recommends that the PC should widen its consideration to all types of vertically integrated structures, to ensure its findings and recommendations are appropriate to all such structures. Even if the PC believes the focus should only be limited to relationships existing within the financial advice sector, this broader scope is essential.

Benefits to Consumers

As the PC has pointed out, there are advantages to the consumer of financial services providers entering into vertical integration arrangements. Where competition is strong, integration may lead to efficiencies being passed on to the customer in the form of lower prices and/or

[1] Draft Report, page 179

increased product choice[2]. In its *Report 562 Financial Advice: Vertically integrated institutions and conflicts of interest* ("**Report 562**"), ASIC acknowledged that the economies of scale and cost efficiencies resulting from vertically aligned structures may be passed on to the customer and therefore result in improved access to advice[3]. ASIC considers that customers may benefit from these structures if they prefer the convenience of a relationship with a single financial institution. They may also value the perceived safety of a relationship with a large, vertically integrated institution where the customer has trust and confidence in the institution's ability to both deliver financial services and compensate him/her appropriately if ever required[4]. The FSC considers that large vertically aligned institutions may be more willing to invest significant resources in product innovation and enhanced service offerings for its customers, providing a range of benefits to customers to better meet their needs. Further, many customers appreciate having a variety of ways in which to access services including physical branches, contact centres, and digital/online methods.

Product bundling

The Draft Report states that the practice of large ADIs bundling products together may make it harder for other players to compete for those products in the relevant markets[5].

However, as the PC points out, there can be significant advantages to the customer from product bundling, such as increased product choice, lower cost of products (assuming providers pass costs savings on to the customer) and the convenience of having many products with the one provider. The FSC considers that product bundling may even have the effect of improving customers' financial literacy given it may inform them of financial risks that they were not otherwise aware of, and suggesting products which may assist to lessen or manage that risk. Of course, as with any cross-selling opportunity, a customer is free to decide not to participate in the bundling opportunity and instead obtain unbundled financial products.

The FSC supports rigorous assessment of customer suitability to ensure customers acquire financial products that are appropriate to their personal circumstances. It supports the intent behind the proposed amendments to the *Corporations Act* regarding product design and distribution obligations.

Regarding the PC's concerns about the effects of product bundling on new entrants, bundling may create some barriers to entry, however this may not affect greatly the competition in the market itself. Using the life insurance industry as an example, there are currently 29 companies registered under section 21 of the *Life Insurance Act*.

ASIC Report 562

The PC relies upon ASIC's Report 562 to highlight the proportion of funds invested in in-house products[6] in the platforms market, and to question generally the effect on competition of Licensee's use of approved product lists ("**APLs**"). It is important to note that Report 562 considers only one kind of vertically integrated structure and that structure as it applies to only five corporate groups. The Report refers to superannuation funds providing financial advice

[2] Draft Report, page 180
[3] ASIC Report 562, page 15
[4] ASIC Report 562, page 15
[5] Draft Report, page 185
[6] The FSC adopts the definition of "in-house products" and "external products" from the Draft Report.

and smaller advice licensees partnering with product issuers as other examples of vertical integration. However, neither such structure is examined further.

Regarding the platforms market, as the PC has pointed out, this is a market that requires a high level of investment in order to participate, hence the FSC submits that, by its very nature, it will be highly concentrated as few firms would be prepared to outlay the initial and ongoing investment to maintain a platform. When an adviser advises a client to invest in an in-house platform, it does not mean that the FUM[7] the customers invests remains with the platform operator. Rather, given platforms hold a mix of both in-house and external products, the client's money is invested in a number of different products or entities. Fees charged by the platform operator to the client for the services it provides are disclosed to clients at the time of investment and on an ongoing basis.

As for APLs, advisers consider them to be valuable tools in the advice process. APLs serve as a risk management mechanism for both advisers and Licensees as research has already been conducted on the products on the APL to ensure they are suitable for the Licensee's clients. APLs offer cost savings for Licensees and efficiencies to advisers, providing them with comfort that the products on the APL have been reviewed and approved by the Licensee's own internal governance. The value of APLs has also been recognised outside the industry in that often professional indemnity insurance cover can be voided if the adviser makes a recommendation outside the APL and does not obtain the Licensee's prior approval. APLs for investment products can be particularly helpful in ensuring advisers do not recommend complex, high-risk investments to retail clients whose risk appetites are not aggressive.

Where an APL is in place, advisers are not obliged to only recommend those products on it. Most Licensees have an "off-APL" approval process whereby an adviser can recommend products that are not on the APL if such advice is in the client's best interests.

In December 2017, at the request of the Federal Government[8], the FSC published *Standard 24 Life Insurance Approved Product Lists Policy* which obliges its members to have a choice of three or more life insurance providers on its APL. Many of the APLs of FSC members far exceed this minimum requirement. Standard 24 recognises that the adviser's obligation to ensure he/she provides advice in the best interests of the client is paramount, and the APL must be constructed with this duty in mind.

The FSC considers that advice quality is continuing to improve given both the Future of Financial Advice Reforms ("**FOFA**") and Life Insurance Remuneration Reforms ("**LIF**") are now law. While FOFA laws have been in effect since 2013, further clarification is still required as to their application, particularly in regard to the interpretation of the best interest duty and in the characterisation of some benefits as conflicted remuneration. ASIC has acknowledged that there has been some improvement in Licensees' practices compared to the findings from its

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[7] FUM refers to Funds under Management and we have adopted the definition of this term from the Draft Report.

[8] Kelly O'Dwyer Media Release, 'Government announces significant improvements to life insurance industry', 6 November 2015

previous surveillance work, which was undertaken before FOFA.[9] LIF laws came into effect on 1 January 2018.[10]

Following ASIC's comments in Report 562, the FSC understands that its members will carefully examine which products on their APLs advisers are recommending, to detect any trends that may indicate that advisers are not fully complying with the law.

Standard 24 also obliges advisers to disclose to their clients the number of providers on their life insurance APL. ASIC has asked the FSC to consult with its members on public reporting of all APLs its members use. The FSC is currently consulting with its members on this issue.

Effects of the FOFA Laws

The FSC notes the PC's finding that FOFA has contributed to more consolidation in the asset management and financial markets.[11] However, it also notes both the impact of technology (which may have the effect of lowering barriers to entry), and the trend for conglomerate financial services businesses to divesting parts of their wealth management arms[12].

The FSC does not consider that a potentially narrower range of products has significantly affected competition in the market. This is so because participants in the market are inclined to monitor and benchmark each other's products to ensure their competitor's products are not more attractive than their own. The FSC considers that customers have gained overall from the law reform given that the advisers and Licensees remaining in the market have shown a commitment to providing advice within the parameters of FOFA.

Recommendations

Overall, the FSC supports the recommendations the PC has made regarding vertical integration. The FSC believes it is important that the PC understand the variety of vertically integrated business models within the financial services sector so that it can consider the impact of recommendations across all models, ensuring no unintended consequences arise.

The FSC provides the following further specific comments on the recommendations:

1. *Make full use of the existing regulator powers to identify and address where integration might substantially lessen competition and efficiency, or impose barriers to entry.* The FSC supports this recommendation provided a definition of vertical integration is agreed, and suggests that consideration be given to extending the merger provisions under the *Competition and Consumer Act* so that the ACCC can take into account the effect of 'creeping acquisitions';
2. *Firms that are undertaking mergers or acquisitions within the financial system should notify the ACCC and ASIC on the nature and size of these acquisitions as they undertake them.* While the FSC supports this proposition in principle, careful consideration is required as to what additional information is necessary given much information is already provided to the ACCC on an acquisition. The FSC is unsure as to whether the

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[9] ASIC Report 562, page 8

[10] References to the FOFA Reforms and the LIF Reforms are to the reforms referred to on page 556 of Appendix D to the Draft Report.

[11] Draft Report, page 193

[12] Draft Report, page 197

recommendation envisages information being provided sooner. The FSC foresees difficulties in providing information too prematurely (such as before the agreement is finalised) as much of that information would be confidential (and possibly price sensitive), and such disclosure may affect the result itself.

3. *ASIC should maintain a publicly accessible database of the relationships between parent and subsidiary companies, and report annually on all notifications received.* While the FSC agrees that the ownership structures in vertically integrated models (adopting the broader definition of this term as referred to above) should be better understood, it notes that such information:
    - is publicly available on ASIC's website on the Financial Advisers Register; and
    - is generally contained in the Financial Services Guide an adviser provides to his/her clients.
4. *Basic indicators of integration be devised (with relevant data collected on a regular basis).* The FSC supports this recommendation and considers that such indicators and data collection could discourage vertically integrated structures from refraining to pass on the benefits of economies of scale to the customer.[13] The FSC considers that the basic indicators and the data collected to formulate such be open to consultation with its members to ensure it is fit for purpose and sufficient transition time is given (in order to avoid significant compliance costs).

Definition of "Digital Advice"

Chapter 7 also contains a definition of "digital advice".[14] The FSC considers this definition to be too narrow, given that the instances of digital or robo-advice that currently exist in the market are numerous and diverse. See the attached Appendix which contains an updated definition for your consideration (with additions highlighted).

Chapter 12 Advice and information

The FSC's members seek to make submissions on three matters referred to in this chapter, which are considered in detail below.

Vertical integration

The PC has not provided any reasoning as to why it considers that, for vertically integrated structures, an inherent conflict of interest exists between the financial advice Licensee's interest in its in-house products and the customer's interest in receiving advice that is in his/her best interests. The FSC is keen to determine why the PC considers this to be the case. The FSC submits that there are a number of instances where such a conflict of interest may not arise, one of which is where a client engages an adviser from ABC Financial Planning because he/she is an existing customer of ABC Banking Group and would like advice about ABC products. The adviser does not receive conflicted remuneration from his/her employer ABC Financial Planning, and is therefore not remunerated based on the amount or value of ABC products he/she recommends.

[13] Benefits flowing from economies of scale could be passed on to the customer through lower prices, improved product quality, investment in new technologies and more customer-centric advice processes.
[14] Draft Report, page 201

In any event, the FSC's members are committed to managing conflicts of interest and have implemented policies and procedures to this end.

The PC report refers to ASIC research which is to be released on APLs and vertical integration, and indicates that the results of ASIC's research will be incorporated into its final report. The FSC does not know whether this is a reference to Report 562, which is considered extensively in Chapter 7 of the Draft Report, or another report. As vertical integration is an important issue to many of the FSC's members, it would appreciate the opportunity to respond to the findings of the research to which the PC refers before the PC publishes its final report.

Financial advisers providing credit services

The FSC refers to the PC's Information Request 12.1 in which the PC states it is considering recommending that ASIC-licensed financial advisers be able to provide advice on some credit products, in particular home loans, personal loans and credit cards.

The FSC supports the proposed recommendation. It is sensible streamlining of the licence arrangements and will assist financial advisers to improve outcomes for consumers.

In this submission, for convenience and to avoid confusion with terms used under the credit licencing regime under the *National Consumer Credit Protection Act 2009* ("**NCCP**"), the term "**credit advice**" refers to the PC's proposal to recommend ASIC-licenced financial advisers be able to provide advice on some credit products. It appears the PC's proposal broadly relates to activities (on certain credit products) which would be "credit assistance" under the NCCP. However, the FSC assumes that the proposal would involve an authorisation to provide credit advice under an AFSL issued under the *Corporations Act*, rather than requiring a Licensee to also obtain a credit licence. The FSC considers that the proposal would only be feasible if the AFSL regime under the *Corporations Act* was leveraged to facilitate credit advice on some credit products by licenced financial advisers, rather than requiring the Licensee to also hold a credit licence under the NCCP.

Financial Advisers operate under an ASIC-supervised AFSL regime. As a part of this framework, advisers are authorised by their Licensee to provide advice in many different areas, including Life insurance, Superannuation, SMSFs, Investments, and other financial services. Some of these specialised areas require an adviser to hold qualifications related to that specialisation and be authorised accordingly. The Licensee is responsible for meeting its licensing obligations which includes having a compliance framework in place that provides for the monitoring and supervision of its financial advisers.

The PC's draft recommendation to allow advisers to provide advice on some credit products is a sensible and logical position for a number of reasons. An adviser is required to act in the best interests of clients as per section 961B of the *Corporations Act*, and to provide appropriate advice under section 961G. These duties require an adviser to understand each client's objectives, financial situation – including assets, liabilities, income, expenditure - and their needs. Accordingly, with this level of client information and these duties, an adviser is well placed to advise on a consumer's credit needs by providing limited credit advice.

Additionally, financial planning clients already turn to their advisers for financial advice. Credit advice is often an integral and significant component of a long term financial strategy to meet life goals such as saving for a first home through to retirement.

The FSC supports limiting the credit products being advised to:

(a) home loans;
(b) personal loans;
(c) credit cards;
(d) commercial property lending;
(e) home equity redraws, reverse mortgages and other equity release schemes;
(f) loan specific servicing;
(g) debt retirement;
(h) personal (novated) leasing; and
(i) limited recourse borrowing arrangements under SMSFs.

Advisers who wish to have authority under their AFSL to provide credit advice should be required to hold a specific authorisation under their AFSL to provide credit advice. In addition, the Financial Adviser Standards and Ethics Authority should consider the entry and ongoing education requirements for advisers should the scope be extended to include limited credit advice. The Licensee would also be responsible for conducting the necessary investigations into the adviser's qualifications prior to issuing the appropriate authority to the adviser. The Licensee would also be responsible for vetting the credit advice of the adviser, ensuring appropriate ongoing training is undertaken, and all other compliance-related activities in order to meet its supervision and monitoring obligations.

Additionally, Licensees would be required to have their AFSL varied to include the addition of a "limited credit advice" authorisation. The Licensee itself would therefore need to have the competencies to cover the limited credit advice authorisation for ASIC to approve this variation to their AFSL.

A concise definition of "limited credit advice" would be required and Licensees could be required to have direct accreditation with lenders or through a current finance aggregator.

The FSC considers that the existing obligations of Licensees and advisers under Chapter 7 of the *Corporations Act* are sufficient to cover limited credit advice. The FSC expects that there would be some streamlined form of responsible lending assessment/obligation accommodated under any modified AFSL regime which facilitated an authorisation to provide credit advice.

Renaming General Advice

The FSC supports the PC's recommendation to rename General Advice[15] and considers that the term 'advice' should only be used in circumstances where a consumer's individual objectives, financial situation and needs are taken into account. The FSC considers that the new nomenclature be subject to rigorous consumer testing before an appropriate term is adopted.

The FSC considers that the distinctions between Personal Advice, General Advice (or whatever it is referred to in the future) and factual information should remain.

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[15] This term is defined in section 766B of the *Corporations Act*

The FSC would be concerned if this change in nomenclature reduced its members' ability to have simple conversations with their customers about their financial needs. Previous research has shown the majority of Australians prefer to receive advice 'piece by piece as required'[16]. The FSC submits that to only permit the delivery of either factual information or fully comprehensive Personal Advice would be out of step with these consumer preferences.

Costs associated with renaming General Advice could be minimised by ensuring sufficient transition timeframes. The FSC suggests a minimum of 18 months to align with regular updates to disclosure documents such as Product Disclosure Documents and Financial Services Guides. This timeframe would also allow Licensees to train their financial advisers on the changes.

To manage the costs of advice, streamlining the regulatory and compliance burden should continue to be a focus of all reforms. This should include consolidating obligations where there is clear overlap and removing duplication in regulatory settings. An example would be providing for the product design and distribution obligations without creating overlap and duplication with the best interests duty.

The FSC refers to Information Request 12.2 and comments as follows.

- The FSC submits that there is a role for Personal Advice and what is currently referred to as General Advice. Some customers seek specialist and detailed financial product advice which considers the customer's individual objectives, financial situation and needs. Other consumers choose to "self-help" using resources available on websites, information from call centres or material issued by product providers, all of which may constitute General Advice.
- It is important to note that product issuers habitually provide General Advice (about markets, or in areas relevant to - but not just limited to - the particular product issued). Some licensees (the General Advice model) fill the void for those customers who may not wish to, or choose not to, obtain Personal Advice.
- The FSC does not support amending the regulatory framework currently in place for providing Financial Product Advice. Members want to ensure that any change to nomenclature will not detrimentally affect access to advice, and that the ability to:
    - provide scaled advice; and/or
    - make targeted statements which, on their own do not amount to Personal Advice, but are designed to assist customers generally to make financial decisions,

  is retained.

The FSC is concerned that significant amendments to parts of Chapter 7 of the *Corporations Act* may have unintended consequences, such as the ability to avoid FOFA, which would be detrimental to the consumer.

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[16] Report 224: Access to financial advice in Australia, ASIC 2010.

Appendix D Asset Management and financial advice

The FSC suggests the following changes be made to Appendix D to improve the accuracy of this appendix and to avoid any confusion regarding the current status quo:

1. Page 553, the first sentence under the heading "Financial advice" be amended so that it reads:
   "Given they recommend financial products and services to their clients, ~~F~~financial advisers are ~~an important~~ often used as a distribution channel for financial products (chapter 7). However this role is limited given they have the following duties under the Corporations Act:
   - *best interest obligation (see Box D.5);*
   - *duty to give appropriate advice; and*
   - *duty to prioritise a client's interests over their own."*

   Reason for change: Clients receive much value from obtaining advice from a financial adviser such as giving peace of mind, providing greater control over one's finances and improving the prospect of a more comfortable retirement[17]. The wording in the Draft Report does not reflect this and as such the FSC considers it may be misleading.

2. Page 556, under "ban on conflicted remuneration and other remuneration", amend the following sentence so that it reads:
   "Volume-based benefits are presumed to be conflicted remuneration, ~~unless it is~~ that is benefits that are dependent on the total value or number of financial products of a particular class or classes recommended by an adviser and/or acquired by a retail client".
   Reason for change: the wording in the Draft Report is inconsistent with the *Corporations Act.*

3. Page 556, under "charging ongoing fees to clients", amend the following sentence so that it reads:
   "financial advisers must renew their client's agreement to the ongoing fee arrangement every two years, ~~and give~~ by giving clients a renewal notice ~~and fee disclosure~~ in relation to the arrangement ('opt-in requirement'). Clients must "opt-in" to continue to receive services under that arrangement."
   Reason for change: the wording in the Draft Report is not very clear and customers may become confused between their right to a Renewal Notice and a Fee Disclosure Statement, which are two separate obligations on the part of a financial adviser.

4. Page 556, under the heading "Later FOFA amendments", the FSC considers the sentence:
   "Also, the best interests obligation (s.961B) and duty to give priority to client's interests (s. 961J) now expressly refer to insurance products."
   to be somewhat misleading as the *Corporations Amendment (Financial Advice Measures) Act 2016 (Cth):*

   - narrows the best interests obligation; and
   - provides that the duty to give priority to client's interests does not apply,

   to advice on general advice.

[17] See 'Value Proposition of Financial Advisory Networks' KPMG EconTech, 18/1/11, available at: [insert webpage]

The two duties applied to life insurance products since 2013.

Under that same heading, the sentence:
"ASIC will have power (by legislative instrument) to set benefit ratios (maximum commission levels and clawback requirements"
is not particularly helpful as ASIC made the legislative instrument in May 2017. It would assist if the benefit ratios and clawback requirements were set out in full.

5. Page 560, under the heading "Consumers" the bullet point:
"to avoid receiving conflicted remuneration"
may be misleading as the paragraph appears to indicate that the ban on conflicted remuneration only applies to personal advice, when the ban in fact applies to both kinds of financial product advice.

6. Page 564, under the heading "Cost of financial advice", the below paragraph be amended as follows:
"In 2016, ASIC investigated the major banks, AMP and Macquarie, and found several instances of fees ~~for no service. This related to cases where customers were subject to automatic periodic payments (including commissions), even though there was no clear agreement between advisers and customers about what specific services would be provided in return for these automatic payments~~ charged under ongoing services arrangements where not all services referred to in those arrangements were provided."
Reason for change: the FSC considers that the wording in the Draft Report misrepresents the findings from ASIC's investigation.

7. Page 575, under the heading "Distribution – alignment of financial advisers", amend the below sentence as follows:
"those that are ~~backed by~~ aligned to a financial institution (often referred to as aligned or tied advisers)."
Reason for change: the use of the word "back" implies that the financial institution guarantees the performance of the financial adviser, which is not always the case.

8. Page 578, explanation **b** under the graph. The FSC submits that the explanation is unclear as it appears to delineate between financial advisers operating under an Australian Financial Services Licence ("**AFSL**") and those that are not. Under the *Corporations Act*, all financial advisers must operate under an AFSL.

9. Page 583, under the heading "Performance" the FSC submits that the sentence:
"However, it is difficult to determine whether this is due to fees, investment or product volumes, vertical integration, or a combination of these factors."
is not very helpful as volume based shelf space fees are now banned and the text does not point this out. The FSC suggests the ban be referenced here.

APPENDIX

"Digital Advice"

Market studies also point to consumers now wanting one-stop-shop wealth management offerings (subs. 26, 40). For financial services organisations to remain relevant in the age of digital technology, they need to continue to find more ways to service consumers via digital technology. As a result, the role of digital is broad. Consumers expect access to digital services and solutions that allow them to manage their wealth no matter how simple or complex the task, from viewing the balances of their accounts and transferring money, through to making investment choices within their products. They also expect these services to be connected to other channels, such as direct or face to face advice, making it easy to transition should they switch channels or need support.

To this end, digital and more scaled advice may improve the affordability of, and meet the demand for, financial advice by lowering its cost. This includes the provision of personal financial advice. Digital advice refers to:

- partly or fully automated financial product advice provided using algorithms and technology with no or limited direct involvement of a human adviser (also known as 'robo-advice' or 'automated advice' — chapter 12 and appendix D); and
- technology which is designed to automate some of the advice process which may not be visible to the customer.

Australian licensees are now actively developing their own digital advice models, having observed its growing popularity in the United States and Europe since 2012 (sub.40).

Digital advice has the potential to increase competition in the financial advice industry and disrupt current supply chains. New advice providers are entering the financial advice market, including overseas digital advice providers in the coming years. And the costs associated with starting a digital advice business in comparison with a traditional advice business are relatively low, reducing barriers to entry — typically, a digital advice business will require fewer staff and will not require a large physical presence.

Since 2014, start-up licensees and existing licensees have been developing or launching digital advice models. ASIC (sub. 40) expects this growth to continue given the number of start-up businesses that have approached ASIC through its Innovation Hub.