Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Some Features of the Australian Financial Planning Industry

Background Paper 6 (Part A)

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1. Purpose of the Paper

This background paper provides information about the key participants in the Australian financial planning industry, some features of this industry, the main services offered by financial planners and advisers, as well as an outline of a selection of regulatory issues.

For the purposes of this paper, the terms ‘financial planning’ and ‘financial advice’ (including the corresponding terms ‘financial planner’ and ‘financial adviser’) are used interchangeably.[1] This paper has been prepared (and the chart has been constructed) using public information.

This paper illustrates the following key points:

a) The number of financial advisers has increased 41% since November 2009;

b) 44% of advisers (both aligned and non-aligned) operate under a licence controlled by the largest 10 financial institutions;

c) The majority of financial advisers are located in the eastern states of Australia (particularly NSW and Victoria);

d) The main topic areas of financial advice sought are on superannuation and investment advice, loans and investment advice, self-managed superannuation fund advice, other services and tax advice;

e) Recent information published by ASIC illustrates the impact an approved product list may have on the financial advice provided to retail clients; and

f) The Future of Financial Advice reforms has sought to address conflicts of interest issues by introducing, among other matters, three conduct obligations for advisers providing financial advice to retail clients, as well as banning certain remuneration arrangements (most notably, conflicted remuneration).

[1] ASIC, *Financial Adviser* MoneySmart (28 July 2017), <https://www.moneysmart.gov.au/glossary/f/financial-adviser>; ASIC, *Financial Planner* MoneySmart (28 July 2017), <https://www.moneysmart.gov.au/glossary/f/financial-planner>.

2. Introduction

Financial planners or advisers seek to play an important role in helping individuals and households in Australia make the most of their finances and achieve their financial goals. They seek to do this by advising and helping retail investors understand and evaluate, among other matters, the right financial products and services for their needs.[2]

Public information indicates that between 20% to 40% of the Australian adult population use, or have used, a financial planner or adviser.[3] The Productivity Commission recently observed that 48% of Australian adults indicated having unmet financial advice needs.[4]

3. Australian financial planning industry

The Australian Securities and Investments Commission ('ASIC') has noted that some of the benefits of accessing financial advice for consumers and retail investors include financial and psychological benefits for individuals, as well as some cited economy-wide fiscal and competitive improvements.[5]

3.1. Main industry participants

A **financial planner (also known as a financial adviser)** is a 'person or authorised representative of an organisation licensed by ASIC to provide advice on some or all of these areas: investing, superannuation, retirement planning, estate planning, risk management, insurance and taxation'.[6] As ASIC has noted, the terms 'financial planner' and 'financial adviser' are commonly interchangeable in general usage.[7]

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2 See generally ASIC, *Report 224: Access to Financial Advice in Australia* (December 2010), 7–10 <http://download.asic.gov.au/media/1343546/rep224.pdf>.

3 Ibid 14; Australian Transaction Reports and Analysis Centre, *Australia's Financial Planning Sector: Money Laundering and Terrorism Financing Risk Assessment* (December 2016), 2 <http://www.austrac.gov.au/sites/default/files/financial-planning-sector-risk-assessment-WEB.pdf>.

4 Productivity Commission, *Draft Report: Competition in the Australian Financial System* (January 2018), 355 <https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft.pdf>.

5 ASIC, *Report 224*, above n 2, 8–10.

6 ASIC, *Financial Adviser* MoneySmart (28 July 2017), <https://www.moneysmart.gov.au/glossary/f/financial-adviser>; ASIC, *Financial Planner* MoneySmart (28 July 2017), <https://www.moneysmart.gov.au/glossary/f/financial-planner>.

7 Ibid.

From 1 January 2019, there will be restrictions on who can call themselves a 'financial planner' or a 'financial adviser'.[8]

Financial advice is regulated under the *Corporations Act 2001* (Cth) as 'financial product advice'.[9] For the purposes of this paper, general references to 'financial advice' are to this Corporations Act concept. As providing financial product advice is providing a 'financial service',[10] a financial planner or adviser must either hold an Australian financial services licence ('AFSL') or operate under an exemption to this licensing requirement (for example, by providing financial services as a representative of an AFS licensee).[11] A 'representative' of an AFS licensee is:

- An 'authorised representative'[12] of the licensee;
- An employee or director of the licensee;
- An employee or director of a related body corporate of the licensee; or
- Any other person acting on behalf of the licensee.[13]

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8 See *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth), Sch 1, Pt 1, item 17, which introduced a new s 923C into the *Corporations Act 2001* (Cth) to impose restrictions on the use of the terms 'financial adviser' and 'financial planners'. See further Explanatory Memorandum, Corporations Amendment (Professional Standards of Financial Advisers) Bill 2017, [2.57]–[2.66]; ASIC, *Professional Standards for Financial Advisers – Reforms* (13 February 2018), <http://asic.gov.au/regulatory-resources/financial-services/professional-standards-for-financial-advisers-reforms/>; ASIC, *Regulatory Guide 175: Licensing: Financial Product Advisers – Conduct and Disclosure* (November 2017), 24–25 <http://download.asic.gov.au/media/4543983/rg175-published-14-november-2017.pdf>.

9 'Financial product advice' is defined as 'a recommendation or statement of opinion, or a report of either of those things, that: (a) is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial products or an interest in a particular financial product or class of financial products; or (b) could reasonably be regarded as having been intended to have such an influence': *Corporations Act 2001* (Cth), s 766B(1). See also ASIC, *Regulatory Guide 36: Licensing: Financial Product Advice and Dealing* (August 2013), 7–15, <http://download.asic.gov.au/media/1238108/rg36-published-20-august-2013.pdf>.

10 *Corporations Act 2001* (Cth), ss 766A, 766B.

11 Ibid ss 911A(2)(a) and 911B; ASIC, *Regulatory Guide 36: Licensing: Financial Product Advice and Dealing* (June 2016), <http://download.asic.gov.au/media/3889417/rg36-published-8-june-2016.pdf>.

12 An 'authorised representative' is a person authorised by an AFS licensee, in accordance with ss 916A or 916B of the *Corporations Act 2001* (Cth), to provide a financial service or services on behalf of the licensee: see *Corporations Act 2001* (Cth), s 761A (definition of 'authorised representative').

13 Ibid s 910A(a) (definition of 'representative').

Financial adviser AFSL holders are subject to general licensee obligations, conduct and disclosure obligations as well as additional obligations for providers of financial product advice to retail clients.[14] There are also some obligations that can also apply directly to representatives.[15]

Financial planners or advisers can organise and operate in **dealer groups (also known as financial advisory networks)**. Under this structure, a corporate entity in the group will hold an AFSL, permitting the financial advisers who are members of the dealer group to operate as its authorised representatives and provide financial advice to consumers on its behalf.

Such financial advisers provide financial advice to consumers under both the AFSL and the commercial brand of the dealer group.[16] In return, dealer groups provide their members centralised back office services support.[17]

Financial advisers (and dealer groups) can be classified as either being **independent/non-aligned** or **aligned** with a financial institution, such as a bank or a wealth management services provider.[18] Financial advisers can only use the terms ‘independent’ or ‘non-aligned’ (or similar words or expressions) in relation to their business if they meet the requirements under s 923A of the *Corporations Act 2001* (Cth) by not receiving commissions, volume-based payments, other gifts or benefits from a product issuer and operate without any conflicts of interest arising from their associations or relationships with a product issuer.[19] For aligned financial advisers, the Productivity Commission has recently noted the various ways alignment can occur, including ‘via vertical ownership structures, contractual relationships, commissions and other forms of remuneration’.[20]

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[14] ASIC, *Regulatory Guide 36*, above n 11, 33–36.
[15] Ibid 37.
[16] See generally Productivity Commission, *Draft Report*, above n 4, 575.
[17] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia – ASIC submission* (August 2009) 109 <https://download.asic.gov.au/media/1311547/ASIC-submission-PJC-Financial-Products-and-Services-Inquiry-2009.pdf>.
[18] Productivity Commission, *Draft Report*, above n 4, 575.
[19] See also ASIC, *17-206MR ASIC clarifies its position on the use of 'independently owned' under s923A* (27 June 2017), <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-206mr-asic-clarifies-its-position-on-the-use-of-independently-owned-under-s923a/>; ASIC, *Regulatory Guide 175*, above n 8, 20-24.
[20] Productivity Commission, *Draft Report*, above n 4, 575.

Digital advice providers (also known as 'robo-advice' or 'automated advice' providers) provide 'automated financial product advice using algorithms and technology and without the direct involvement of a human adviser'.[21] They are generally premised on offering financial product advice for consumers that is more convenient and cost effective than 'traditional' advice from a person.[22]

According to ASIC, the 'provision of digital advice has grown rapidly in Australia since 2014', with a number of existing and new AFS licensees developing digital advice models.[23] Digital advice providers are regulated by ASIC in the same manner as human providers of financial product advice.[24]

For the purposes of this paper, **consumers** are individuals seeking financial advice on how they should act in respect of their personal financial affairs. They would typically be classified as 'retail clients' under the *Corporations Act 2001* (Cth).[25]

3.2. Changes in the number of financial advisers

In August 2009, there were around 18,000 financial advisers in Australia working for 749 advisory groups operating over 8,000 practices'.[26]

More recent information from ASIC shows that, as at 1 April 2018, there were 25,386 financial advisers registered in Australia,[27] an increase of around 41% compared with the number of financial advisers in August 2009.

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21 ASIC, *Regulatory Guide 255: Providing Digital Financial Product Advice to Retail Clients* (August 2016), 4, <http://download.asic.gov.au/media/3994496/rg255-published-30-august-2016.pdf>.

22 See generally ASIC, *Robo-advice*, MoneySmart (10 November 2017), <https://www.moneysmart.gov.au/investing/financial-advice/robo-advice>.

23 ASIC, *Regulatory Guide 255*, above n 21, 4; ASIC, *Productivity Commission Inquiry into Competition in the Australian Financial System: Submission by the Australian Securities and Investments Commission* (September 2017), 62, <https://www.pc.gov.au/__data/assets/pdf_file/0014/222170/sub040-financial-system.pdf>.

24 See generally ASIC, *Digital advice*, <http://asic.gov.au/for-business/your-business/innovation-hub/licensing-and-regulation/digital-advice/>.

25 A client for a financial service (including financial product advice) will generally be a 'retail client' unless an exception under s761G(5), (6), (6A) or s 761GA applies: see *Corporations Act 2001* (Cth), s761G(1). Note that small businesses may be treated as 'retail clients' in certain circumstances, see further *Corporations Act 2001* (Cth), s 761G(7)(b) and s 761G(12) (definition of 'small business').

26 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia – ASIC submission (August 2009) Page 108 <https://download.asic.gov.au/media/1311547/ASIC-submission-PJC-Financial-Products-and-Services-Inquiry-2009.pdf>

27 Australian Government, *ASIC – Financial Advisers Dataset* (1 April 2018), <https://data.gov.au/dataset/asic-financial-adviser>.

According to other public information from ASIC, as at 1 June 2017, there were 5,822 AFS licensees that offered financial advice services to consumers in Australia, with the majority (4,168 or approximately 72%) authorised to provide personal advice.[28]

3.3. Industry size and composition

3.3.1. Size of the Australian financial planning industry

The size of the Australian financial planning industry can also be illustrated by a number of measures derived from publicly available information.

The Productivity Commission has noted that in '2015–16, Australia's financial planning sector was estimated to be worth $4.6 billion in revenue'.[29] It has also noted that 'industry revenue growth has declined, particularly in the past few years'.[30] It further observed that the top 5 entities (the four major banks and AMP) 'collectively hold a market share of about 48% by industry revenue'.[31]

ASIC has noted that 2.3 million Australians aged 18 and over have received advice from a financial planner in the 12 months to July 2016.[32]

3.3.2. Composition of the Australian financial planning industry

In August 2009, the then largest 20 dealer groups held approximately 50 per cent of market share, and 85% of financial advisers at that time were associated with a product manufacturer.[33]

More recently, the Productivity Commission has published the following information on the concentration found within the Australian financial planning industry, based on the ASIC Financial Advisers Register as at 3 October 2017:[34]

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28 ASIC, *Productivity Commission Inquiry into Competition in the Australian Financial System: Submission by the Australian Securities and Investments Commission – Appendices* (September 2017), 84, <http://www.pc.gov.au/__data/assets/pdf_file/0015/222171/sub040-financial-system-attachment.pdf>.

29 Productivity Commission, *Draft Report*, above n 4, 575.

30 Ibid.

31 Ibid 572.

32 ASIC, *ASIC's Corporate Plan 2017–18 to 2020*–21, 5, <http://download.asic.gov.au/media/4439405/corporate-plan-2017-published-31-august-2017-1.pdf>.

33 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia – ASIC submission (August 2009) Page 109-110 <https://download.asic.gov.au/media/1311547/ASIC-submission-PJC-Financial-Products-and-Services-Inquiry-2009.pdf>.

34 Productivity Commission, *Draft Report*, above n 4, 572.

- 44% of advisers (both aligned and non-aligned) operate under a licence controlled by the largest 10 financial institutions;
- 6 financial institutions – the four major banks, AMP and IOOF Holdings – have over 35% of total (including aligned and non-aligned) advisers operating under a licence they control;
- About 30% of the total number of financial advisers on ASIC's Financial Advisers Register[35] work for one of the major banks; and
- The majority of financial advisory firms are small, with about 78% of advice licensees operating a firm with less than 10 financial advisers, about 90% with less than 50 advisers, and 95% with less than 100 financial advisers. The average number of financial advisers operating under an AFS licence is 34 individuals.

3.3.3. Geographic distribution of financial advisers

The Productivity Commission, drawing on analysis prepared by IBISWorld, recently observed that the 'majority of financial advisers are located in the eastern states – particularly New South Wales and Victoria – close to areas with business and financial centres, high population density and high proportion of high-income individuals'.[36] The Productivity Commission has also published information on the distribution of financial advice establishments in Australia (as a percentage of total financial advice establishments).[37] That information shows that: NSW has the largest share of financial advice establishments (over 30%), followed by Victoria (over 20%), Queensland (under 20%), Western Australia (over 10%), South Australia (under 10%), Australian Capital Territory (under 10%), Tasmania (under 10%) and the Northern Territory (under 10%).[38]

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35 ASIC's Financial Adviser Register was established under the *Corporations Amendment (Register of Relevant Providers) Regulation 2015* (Cth). It was later introduced into the *Corporations Act 2001* (Cth) by the *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* (Cth). It is a register of 'individuals who are authorised to provide personal advice to retail clients on investments, superannuation (including SMSFs) and life insurance': see further ASIC, *Financial Advisers Register - Frequently asked questions on the Financial Advisers Register* (3 August 2017), <http://asic.gov.au/for-finance-professionals/afs-licensees/financial-advisers-register/frequently-asked-questions-on-the-financial-advisers-register/>.

36 Productivity Commission, *Draft Report*, above n 4, 558.

37 Ibid 558 (Figure D.6).

38 Ibid.

4. Services offered by the Australian financial planning industry

As briefly noted above in sections 2 and 3, a key service offered by the Australian financial planning industry is identifying and considering a client's financial needs and goals, and helping them achieve these goals through the development of a financial plan.[39]

It is also possible to identify the range of services offered by the industry from the perspective of the type of financial product advice given, as well as from the perspective of the subject matter topics covered by the financial product advice. Each of these perspectives is outlined below. The impact of dealer group membership on the services provided by financial advisers is also discussed below.

4.1. Types of financial product advice

Under the *Corporations Act 2001* (Cth), there are two types of financial product advice: personal advice and general advice.[40]

Personal advice is defined as financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters.[41]

It can also be further classified as either 'scaled' advice (personal advice that is limited in scope, relating to a single issue or specific range of issues raised by the client) or 'comprehensive' advice (which is personal financial advice providing holistic or full advice covering the client's financial needs).[42]

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39 See, e.g., The Financial Planning Association of Australia ('FPA'), *Competition in the Australian Financial System: FPA submission to Productivity Commission*, (15 September 2017), 2–3, <https://www.pc.gov.au/__data/assets/word_doc/0007/221875/sub026-financial-system.docx>.

40 *Corporations Act 2001* (Cth), s 766B(2). ASIC also draws a further distinction between 'factual information' and financial advice, with the former being 'objectively ascertainable information, the truth or accuracy of which cannot reasonably be questioned': see ASIC, *Regulatory Guide 244: Giving Information, General Advice and Scaled Advice* (December 2012), 10 <http://download.asic.gov.au/media/3336151/rg244-published-25-august-2015.pdf>; ASIC, *Regulatory Guide 36*, above n 9, 8. ASIC will not generally regard providing factual information as financial advice, unless such information is presented in a manner to suggest a recommendation which is intended or can be reasonably intended to influence a client in making a decision about a financial product.

41 *Corporations Act 2001* (Cth), s 766B(3).

42 See generally Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth), [1.34]; ASIC, *Regulatory Guide 244*, above n 42.

General advice is financial product advice that is not personal advice.[43] It can therefore cover a wide range of material, including 'guidance, advertising, and promotional and sales material highlighting the potential benefits of financial products'.[44] The Financial System Inquiry and the Productivity Commission have both made recommendations for the 'general advice' category to be renamed, as the presence of the word 'advice' may mislead or confuse consumers to mistakenly believe that the provided information is tailored to their needs or circumstances.[45] This is despite the requirement to give a 'general advice warning' when providing general advice to a retail client.[46]

This risk of consumer harm may be more acute in relation to financial products sold under a 'general' or 'no advice' sales model.[47] For example, the majority of general insurance products have been reported to be sold on a 'no personal advice' basis.[48] As ASIC has observed, financial products sold on such a basis 'places significant responsibility for good purchasing decisions on the consumer, and may risk consumers being sold a product that they do not need'.[49]

4.2. Main topics covered by financial product advice

The Productivity Commission, drawing on analysis prepared by IBISWorld, has recently presented information on the range of services provided by the Australian financial planning industry from the perspective of the main topics that can be the subject of the financial advice.[50] According to that information, there are five main topics of financial advice sought by consumers, measured as a percentage of the Australian financial planning industry's revenue for the year 2016–17. A brief outline of those topics, including their respective approximate proportions of industry revenue,[51] is provided below.

43 *Corporations Act 2001* (Cth), s 766B(4).
44 Financial System Inquiry, *Final Report* (November 2014), 271, <http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf>.
45 Ibid; Productivity Commission, *Draft Report*, above n 4, 43.
46 See *Corporations Act 2001* (Cth), s 949A.
47 ASIC, *Productivity Commission Inquiry into Competition in the Australian Financial System: Submission by the Australian Securities and Investments Commission*, above n 23, 93.
48 Insurance Council of Australia, *Future of Financial Advice (FOFA): General Insurance Issues* (25 February 2011), 2 <http://www.insurancecouncil.com.au/assets/submission/2011/future%20of%20financial%20advice.pdf>
49 ASIC, *Productivity Commission Inquiry into Competition in the Australian Financial System: Submission by the Australian Securities and Investments Commission*, above n 23, 93.
50 Productivity Commission, *Draft Report*, above n 4, 561.
51 As extracted from Figure D.7 in Productivity Commission, *Draft Report*, above n 4, 561.

Superannuation and retirement advice (the most common type of financial advice sought by consumers, representing approximately one third of industry revenue for the year 2016-17) refers to the advice that seeks to help individuals plan for their financial situation in retirement.[52] It can also include 'intra-fund' fund advice, which is the advice a superannuation trustee can give to members where the cost of that advice is borne by all members of the superannuation fund.[53]

Loan and investment advice (the second most common type of financial advice sought by consumers, representing approximately one quarter of industry revenue for the year 2016-17) refers to the advice for determining the most suitable loan product and financial asset allocation for a consumer. It can also include recommendations by financial advisers on the use of master trusts and wraps to allow an individual to hold a portfolio of investments under one structure.[54]

Self-managed superannuation fund ('SMSF')[55] **advice** (the third most common type of financial advice sought by consumers, representing approximately one fifth of industry revenue for the year 2016–17) mainly concerns the advice received to support the investment and administration decisions made by the trustees (or directors for a corporate trustee) for an SMSF.[56]

Other services (the fourth most common type of financial advice sought by consumers, representing approximately one tenth of industry revenue for the year 2016–17) includes advice activities such as estate planning.

Tax advice (the fifth most common type of financial advice sought by consumers, representing approximately almost one tenth of industry

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52 See generally ASIC, *Superannuation & Retirement* (22 August 2017), <https://www.moneysmart.gov.au/superannuation-and-retirement>.

53 ASIC, *Giving and Collectively Charging for Intra-Fund Advice* (26 September 2016), <http://asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-and-relief/superannuation-advice/giving-and-collectively-charging-for-intra-fund-advice/>; FPA, *Competition in the Australian Financial System: FPA Submission to Productivity Commission*, above n 39, 3.

54 Broadly summarised, a master trust is 'an investment structure that allows an investor to hold a portfolio of managed funds under the one umbrella. It provides centralised reporting and is often used by financial advisers as an easy way to manage their client's portfolio'. A wrap is 'similar to a master trust but it allows an investor to hold investments, such as managed funds and direct shares, under the one umbrella. It is also used by financial advisers to provide centralised reporting and flexibility which may allow the investor to save costs': see ASIC, *Master Trusts and Wraps* (19 April 2017), <https://www.moneysmart.gov.au/investing/financial-advice/meeting-with-a-financial-adviser/master-trusts-and-wraps>.

55 An SMSF is a 'private superannuation fund regulated by the Australian Taxation Office', enabling individuals to manage and make decisions about the fund themselves (including investment decisions): see generally ASIC, *Self-Managed Super Funds (SMSF)* (3 April 2018), <https://www.moneysmart.gov.au/superannuation-and-retirement/self-managed-super-fund-smsf>.

56 Ibid.

revenue for the year 2016–17) in the present context refers to personal financial product advice that also deals with the liabilities, obligations or entitlements that arise or could arise under a taxation law.[57] It is also known as providing a 'tax (financial) advice service'.[58]

4.3. Impact of dealer group membership on services provided

As noted in sections 3.1 and 3.3 above, a proportion of financial advisers in the Australian financial planning industry operate in dealer groups. This section outlines some of the relevant considerations on the issue of the influence membership of a dealer group can have on the financial advice given.

The Future of Financial Advice ('FOFA') legislation introduced reforms in a number of areas,[59] including the introduction of the following conduct obligations for financial advisers providing personal advice to a retail client:

a) An obligation to act in the best interests of their clients when providing personal advice to a retail client (the 'best interests duty'),[60] subject to a 'safe harbour' that financial advisers may rely on to prove they have complied with the best interests duty by showing they have carried out certain steps in advising their clients;[61]

b) An obligation to provide appropriate advice;[62] and

c) An obligation to prioritise the interests of clients ahead of the interests of the adviser (and the interests of certain specified related parties).[63]

Australian financial services licensees must also ensure that their representatives comply with these conduct obligations.[64]

As part of a dealer group structure (see section 3.1 above), the AFS licensee of a dealer group may restrict (under their terms of appointment)

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57 See generally ASIC, *Financial Advisers Providing Tax Advice* (20 October 2014), <http://asic.gov.au/regulatory-resources/financial-services/financial-advisers-providing-tax-advice/>.

58 All financial services licensees and their representatives providing tax (financial) advice services for a fee or other reward must be registered with the Tax Practitioners Board: see generally Tax Practitioners Board, *Who needs to register as a tax (financial) adviser?* (8 June 2017), <https://www.tpb.gov.au/who-needs-register-tax-financial-adviser>.

59 See generally ASIC, *FOFA – Background and Implementation* (20 October 2014), <http://asic.gov.au/regulatory-resources/financial-services/future-of-financial-advice-reforms/fofa-background-and-implementation/>.

60 See *Corporations Act 2001* (Cth), s 961B(1).

61 See, e.g., ibid s 961B(2).

62 Ibid s 961G.

63 Ibid s 961J.

64 Ibid s 961L.

the range of financial products their financial adviser representatives can advise on through an ‘approved product list’.[65] An approved product list may contain ‘in-house’ financial products, as well as external financial products.[66] Where such restrictions occur, membership of a dealer group will influence the financial advice provided, as the range of financial products the adviser can provide financial advice on is limited. ASIC has noted that approved product lists are often used by AFS licensees as a risk management tool.[67] The approved product list within a dealer group is usually not publicly available.[68]

ASIC has expressly recognised that the ‘best interests duty does not prevent or require the use of approved product lists’ and has provided regulatory guidance on how it considers the best interests duty applies in circumstances where there is use of an approved product list.[69]

The intersection of these issues can be illustrated in a report published by ASIC in January 2018, *Report 562: Financial advice: Vertically integrated institutions and conflicts of interest*.[70] This report examined how five of Australia’s largest banking and financial services institutions managed the conflict of interest arising from ‘both providing personal advice to retail clients and manufacturing financial products’.[71]

To arrive at its findings in Report 562, ASIC collected data from the two largest advice licensees (authorised to provide personal advice to retail clients) owned or controlled by each of the five largest banking and financial institutions for the periods 1 July 2014 to 28 February 2015 and 1 January 2017 to 31 March 2017.[72] ASIC then reviewed the composition of each advice licensee’s approved product list and compared the proportion of funds invested by customers in in-house products and external products.[73]

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65 ASIC, *Regulatory Guide 175*, above n 8, 83.

66 In-house financial products are those that are ‘provided by a related party, such as the bank or other financial institution the adviser is employed by’: ASIC, *Financial Products and Sales Incentives* (7 March 2018), <https://www.moneysmart.gov.au/investing/financial-advice/financial-products-and-sales-incentives>. External financial products are those that are from an unrelated financial product provider: Productivity Commission, *Draft Report*, above n 4, 577.

67 ASIC, *Regulatory Guide 175*, above n 8, 83.

68 Productivity Commission, *Draft Report*, above n 4, 577.

69 ASIC, *Regulatory Guide 175*, above n 8, 83.

70 ASIC, *Report 562: Financial Advice: Vertically Integrated Institutions and Conflicts of Interest* (January 2018), <http://download.asic.gov.au/media/4632718/rep-562-published-24-january-2018.pdf>.

71 Ibid 4–5.

72 Ibid 5, 20–21.

73 Ibid 6, 21–23.

ASIC also assessed the quality of the personal advice given by the advisers of the reviewed licensees in February 2015, with a focus on where a recommendation had been made on an in-house superannuation platform to new customers, to determine whether there had been compliance with the three conduct obligations outlined at the start of this sub-section.[74]

According to the results presented in ASIC's *Report 562*, the reviewed financial institutions' approved product lists comprised 21% in-house products and 79% external products. As a result of receiving personal advice from the licensees' advisers, 68% of the total funds invested by customers were placed into in-house products, with 32% of such funds invested in external products.[75] ASIC did note that they did not expect financial advisers to recommend 'in-house' financial products in the same proportion as the number of 'in-house' financial products on an approved products list.[76]

ASIC also found that advisers from the five financial institutions that were the focus of Report 562[77] could only demonstrate compliance with the best interests duty through the use of the safe harbour steps[78] in 25% of the customer files reviewed.[79] Additionally, ASIC found that for 10% of the customer files reviewed, 'it was readily apparent that customers were likely to be significantly worse off as a result of following the advice'[80] and that for the remaining balance of reviewed customer files (65%), these files 'did not demonstrate that the customer would be in a better position following the advice'.[81]

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74 Ibid 6, 23–25.
75 Ibid 10, 29.
76 Ibid 9, 26.
77 Ibid 5.
78 See n 61 and accompanying text.
79 ASIC, *Report 562*, above n 70, 38.
80 Ibid 9. According to Report 562, this assessment was based on certain reviewed customer files which showed that after receiving advice, customers had changed their insurance arrangements to policies that may not have been entirely suited to their particular circumstances and customers had changed to new certain new financial products that had higher fees but without any discernible additional benefits for those customers: see ibid 37.
81 Ibid.

5. Some regulatory issues

5.1. Remuneration arrangements

The remuneration arrangements of the Australian financial planning industry have been the focus of regulatory consideration and legislative activity – most notably the Future of Financial Advice (‘FOFA’) reforms.

The following information provides a brief comparison of the main remuneration arrangements of the Australian financial planning industry before and after the introduction of the FOFA reforms.

5.1.1. Main forms of remuneration arrangements before the FOFA reforms

Prior to the FOFA reforms, the three main remuneration arrangements for the industry were:

a) Fee-for-service;
b) Commissions; and
c) Bonuses

The **fee-for-service** remuneration arrangement is paid to the adviser by the client as an hourly rate, a proportion of funds under management, or as a flat dollar fee.

Commissions are paid to advisers by product manufacturers as either up-front payments as a proportion of the investment or as an ongoing trailing commission. Commissions are effectively payment in exchange for the distribution of the product manufacturer’s financial products.

Bonuses are generally paid to providers by manufacturers for meeting volume targets, otherwise known as volume-based payments.

5.1.2. Main forms of remuneration arrangements after the FOFA reforms

The Australian Government introduced the FOFA reforms primarily seeking to improve retail investor confidence in the Australian financial planning industry by increasing the standard of financial advice and addressing various conflicts of interest issues.[82] The FOFA legislation was passed by Parliament on 25 June 2012 and commenced on 1 July 2012 (and compliance with the FOFA reforms was mandatory from 1 July 2013). A high level summary of the main reforms relevant for remuneration practices is outlined below.[83]

The FOFA reforms[84] introduced a ban on 'conflicted remuneration' relating to financial advice provided to retail clients for a range of financial products.[85] 'Conflicted remuneration' is any benefit (monetary and non-monetary) given to a AFS licensee or its representative who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence:

- The choice of financial product recommended to retail clients by the licensee or representative; or
- The financial product advice given to retail clients by the licensee or representative.[86]

Under this ban, licensees and their representatives must not accept conflicted remuneration.[87] Additionally, financial product issuers and sellers[88] and employers of an AFS licensee or representative[89] must not give conflicted remuneration to a financial licensee or representative.

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82 See generally Australian Government (The Treasury), *Future of Financial Advice*, <http://futureofadvice.treasury.gov.au/Content/Content.aspx?doc=home.htm>; ASIC, *FOFA – Background and Implementation*, above n 62; Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011 (Cth), 3; Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Cth), 3.

83 The FOFA reforms also introduced a requirement for financial advisers receiving fees for giving personal financial product advice under an ongoing fee arrangement with a retail client to provide that client with an annual fee disclosure statement: see *Corporations Act 2001* (Cth), ss 962G and 962H. See also ASIC, *Regulatory Guide 245: Fee Disclosure Statements* (February 2017), <http://download.asic.gov.au/media/4158857/rg245-published-22-february-2017.pdf>.

84 *Corporations Amendment (Future of Financial Advice) Act 2012* (Cth) and *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* (Cth).

85 See *Corporations Act 2001* (Cth), Part 7.7A, Divs 4 and 5.

86 *Corporations Act 2001* (Cth), s 963A. There are also some specified benefits which are not taken to be conflicted remuneration: see ibid ss 963B, 963C and 963D.

87 Ibid ss 963F, 963G and 963H.

88 Ibid s 963K.

89 Ibid s 963J.

This ban would encompass the ‘commissions’ type remuneration arrangements outlined in section 5.1.1 above.[90]

There is now a presumption that volume-based benefits are conflicted remuneration[91] (which would capture the ‘bonuses’ remuneration arrangements outlined in section 5.1.1 above).[92] A benefit is volume-based if access to the benefit or the value of the benefit is wholly or partly dependent on the total number or value of financial products:

(a) recommended to retail clients by an AFS licensee or representatives; or
(b) acquired by retail clients to whom an AFS license or its representatives provide advice.[93]

Financial advisers are also now banned from charging asset-based fees on borrowed amounts that are to be used to acquire financial products by or on behalf of a client.[94] An asset-based fee is a fee for ‘providing financial product advice to a person as a retail client that it is dependent upon the amount of funds used or to be used to acquire financial products by or on behalf of the client’.[95] The policy objective for this ban is to prevent financial advisers from artificially increasing the size of their fees by increasing the amount of a client’s investments based on borrowed amounts.[96]

5.2. Volume of disputes

Australian financial services licensees providing financial services to retail clients are required to have a dispute resolution system that consists of:

a) An internal dispute resolution procedure that complies with the standards and requirements made or approved by ASIC; and

b) Membership of one or more ASIC approved external dispute resolution schemes.[97]

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90 See also ASIC, *Regulatory Guide 246: Conflicted and Other Banned Remuneration* (December 2017), 15, <http://download.asic.gov.au/media/4566844/rg246-published-7-december-2017.pdf> (where ASIC expresses the view that it considers commissions – whether upfront or trailing, fixed or variable – to be examples of conflicted remuneration).

91 *Corporations Act 2001* (Cth), s 963L.

92 See also ASIC, *Regulatory Guide 246*, above n 90, 15–16.

93 Ibid 30.

94 *Corporations Act 2001* (Cth), Part 7.7A, ss 964D (ban for AFS licensees) and 964E (ban for authorised representatives).

95 Ibid s 964F.

96 See ASIC, *Regulatory Guide* 246, above n 90, 54.

97 See *Corporations Act 2001* (Cth), ss912A(1)(g), 912A(2). See also ASIC, *Regulatory Guide 165: Licensing: Internal and external dispute resolution* (February 2018) http://download.asic.gov.au/media/4644516/rg165-published-14-february-2018.pdf>; ASIC, *Regulatory Guide 139: Approval and oversight of external dispute resolution schemes* (June 2013) <http://download.asic.gov.au/media/1240742/rg139-published-13-june-2013.pdf>.

The two ASIC-approved external dispute resolution schemes with financial advisers or planners as members are the Financial Ombudsman Service ('FOS') and the Credit and Investments Ombudsman ('CIO').[98]

5.2.1. The number of disputes accepted by FOS

As at 30 June 2017, around one quarter or 27% of the 13,422 members of FOS were financial advisers or planners.[99] This group made up the largest proportion of FOS membership.[100] In 2016–17, new members who joined FOS were predominantly accountants and financial advisers or planners.[101]

The total number of disputes accepted by FOS in 2016–17 was 25,329, of which 524 disputes (representing approximately 2% of total accepted disputes) concerned a financial adviser or planner.[102] This was a smaller proportion of complaints than in 2009–10,[103] when FOS accepted 1,063 disputes about a financial adviser/planner, making up around 6% of the 17,352 complaints accepted by FOS in 2009–10.[104]

For disputes accepted by FOS in 2016–17, the most common issue for accepted disputes in relation to a financial adviser or planner was for 'advice' activities.[105] Of the 626 disputes about advice accepted by FOS, around half (334 accepted disputes) were in relation to a financial adviser or planner.[106] This was similar to 2009–10, when around 59% of complaints against a financial adviser or planner were in relation to 'advice'.[107]

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98 ASIC, *ASIC-Approved Dispute Resolution Schemes* (16 June 2016), http://asic.gov.au/regulatory-<resources/financial-services/dispute-resolution/asic-approved-dispute-resolution-schemes/>. The Superannuation Complaints Tribunal, an independent tribunal to deal with superannuation-related complaints, does not have jurisdiction in its governing legislation to deal with complaints which are about financial advisers who are not acting as agents of a superannuation provider: Superannuation Complaints Tribunal (SCT), *Annual Report 2016–17,* 6, 9 <http://www.sct.gov.au/dreamcms/app/webroot/uploads/documents/Superannuation%20Complaints%20Tribunal%20Annual%20Report%202016-17%20-%20web.pdf>.

99 Financial Ombudsman Service (FOS), *Annual Review 2016–17*, 24–25, <http://fos.org.au/custom/files/docs/fos-annual-review-20162017.pdf>.

100 Ibid 24.

101 Ibid 25.

102 Ibid 63.

103 This was the first year in which data on disputes accepted by FOS were presented in a similar manner to the data presented in 2016–17.

104 FOS, *2009–2010 Annual Review*, 30 <http://fos.org.au/custom/files/docs/fos_2010_annual_review.pdf>.

105 FOS, *Annual Review 2016–17*, above n 99, 24.

106 Ibid.

107 FOS, *2009–2010 Annual Review*, above n 104, 30.

5.2.2. The number of complaints received by CIO

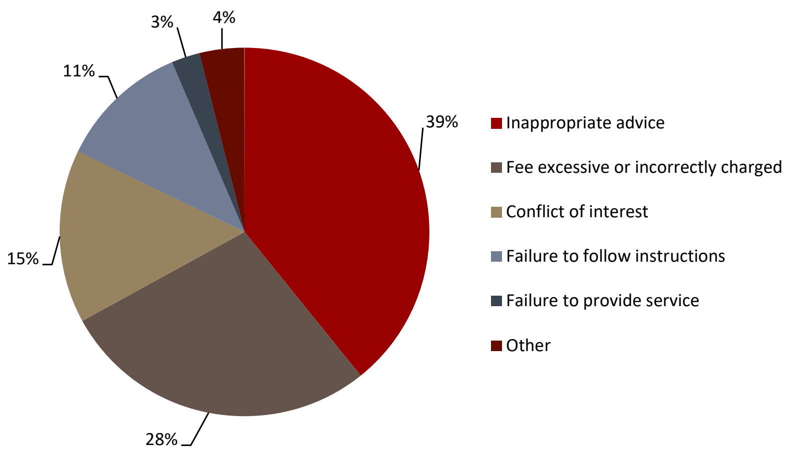
The CIO does not publicly provide information on the number of its members who are financial advisers or planners.

For 2016–17, of the total 5,892 complaints received by CIO, 83 complaints (1.4%) were about financial planners and advisers.[108] This compares to 2012-13,[109] when 78 complaints (2.1%) were about financial planners and advisers.[110]

In 2016–17, 62 complaints (1.1%) to the CIO were about financial advice,[111] compared to 78 complaints (2.1%) in 2012–13.[112]

Of the complaints to the CIO about financial planners and advisers, the largest proportion of complaints was about inappropriate advice (around 39%), followed by excessive or incorrectly charged fees (around 28%), conflict of interest (around 15%) or failure to follow instructions (around 11%). This information is also set out in Chart 1.

Chart 1: Common issues raised in CIO complaints about financial planners and advisers, 2016–17



Source: CIO[113]

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[108] CIO, *Annual Report on Operations 2016/17*, 48 <https://www.cio.org.au/assets/27886550/CIO%202017%20Annual%20Report%20on%20Operations.pdf>.

[109] The year 2012–13 was the first year when both the number of complaints about financial advice and the number of complaints about financial planners and advisers were publicly reported by the CIO, then the Credit Ombudsman Service Limited ('COSL').

[110] COSL, *Annual Report on Operations 2013*, 23, <https://www.cio.org.au/assets/27886802/COSL%20Annual%20Report%202013.pdf>.

[111] CIO, *Annual Report on Operations 2016/17*, above n 108, 47.

[112] COSL, *Annual Report on Operations 2013*, above n 110, 22.

[113] Ibid.

5.3. Professional indemnity insurance

An AFS licensee providing financial services (including providing financial product advice)[114] to retail clients must also have arrangements for compensating those clients for loss or damage suffered because of breaches of the licensee's relevant obligations under Chapter 7 of the *Corporations Act 2001* (Cth) either by the licensee or its representatives.[115] An example would be arrangements for compensating loss suffered by a retail client from improper, unsuitable or otherwise poor quality financial advice.

The usual way AFS licensees comply with this obligation is to hold professional indemnity insurance cover for all the financial products and services they provide.[116] There is a requirement for the professional indemnity insurance cover to be 'adequate',[117] as assessed against the requirements under reg 7.6.02AAA(1) of the *Corporations Regulations 2001* (Cth),[118] including providing cover for liability under any awards by external dispute resolution schemes (see section 5.2 above).[119]

The main policy objective for the 'adequate' professional indemnity insurance requirement is to 'reduce the risk that compensation claims to retail clients cannot be met by the relevant licensees due to the lack of available financial resources'.[120]

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114 See n 10 and accompanying text.

115 *Corporations Act 2001* (Cth), s912B(1). See also ASIC, *Regulatory Guide 126: Compensation and insurance arrangements for AFS licensees* (December 2010), <http://download.asic.gov.au/media/1240688/rg126-20dec2010.pdf>; ASIC, *Report 459: Professional indemnity insurance market for AFS licensees providing financial product advice* (December 2015), <http://download.asic.gov.au/media/3489055/rep459-published-14-december-2015.pdf>; ASIC, *Regulatory Guide 256: Client review and remediation conducted by advice licensees* (September 2016), <http://www.asic.gov.au/media/4009895/rg256-published-15-september-2016.pdf>.

116 ASIC, *Regulatory Guide 126*, above n 121, 4. A licensee can also use alternative arrangements approved by ASIC: *Corporations Act 2001* (Cth), s912B(2).

117 *Corporations Act 2001* (Cth), ss 912B(1), (2)(a); *Corporations Regulations 2001* (Cth), reg 7.6.02AAA(1) and (2).

118 In summary, reg 7.6.02AAA(1) requires licensees to obtain professional indemnity insurance that is adequate, having regard to a number of specified considerations, including the nature of the licensee's business and its potential liability for compensation claims.

119 *Corporations Regulations 2001* (Cth), reg 7.6.02AAA(1)(a). See also ASIC, *Regulatory Guide 126*, above n 115, 17.

120 Australian Government, *Regulatory Impact Statement: Compensation Arrangements for Financial Services Licensees* (April 2007), 7, https://www.legislation.gov.au/Details/F2007L01889/Supporting%20Material/Text.