



JUNE 2022

## ISSUES PAPER

# Submission to The Quality of Advice Review

## ABOUT US

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

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## Introduction

Independent and high-quality financial advice can improve the financial security and wellbeing of Australians. However, conflicts of interest that remain in the advice industry continue to contribute to poor outcomes for many people.

We welcome the opportunity to contribute to the Quality of Advice Review (**'the Review'**). This is an important opportunity to ensure that Australia's financial advice regulatory framework is working to produce high-quality outcomes for people.

This Review was a key recommendation of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**'the Banking Royal Commission'**), which exposed widespread misconduct in the financial advice industry. Many people lost their entire life savings as a result of inappropriate financial advice and continue to suffer ongoing economic and social impacts. The scale of harm prompted recommendations for further reforms, some of which are yet to be implemented.

Commissioner Hayne recommended this Review as an opportunity to “determine whether those changes have been effective in improving the quality of advice.”<sup>1</sup> As a consumer advocate, CHOICE believes there is much more work to do. The collapse of Dixon Advisory which sold conflicted financial products and appalling financial advice provided by timeshare company Ultiqa are two recent examples that highlight the need to abolish conflicted remuneration in the industry.<sup>2</sup>

In light of ongoing scandals, Australians still do not trust the industry to provide high-quality advice. In May 2022, CHOICE and Super Consumers Australia asked people to share their experiences when seeking financial advice.<sup>3</sup> Only one in three (34%) respondents trusted the financial advice industry to provide high-quality advice about their financial news. 70% of people said that they do not trust financial advisers who receive commissions.

This Review has the opportunity to improve the regulatory settings to ensure that people receive high-quality and independent advice, but it is clear that the way in which this review has been established does not allow it to answer the questions posed by Commissioner Hayne.

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<sup>1</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p177

<sup>2</sup> Shapiro, J and LaFrenz, C 2022, *The devastation wrought by Dixon Advisory*, Australian Financial Review, accessed on 17 May 2022, <https://www.afr.com/companies/financial-services/the-devastation-wrought-by-dixon-advisory-20220121-p59q59>, and ASIC 2022, *22-111MR Federal Court finds timeshare company Ultiqa failed consumers with multiple breaches of financial services laws*, accessed on 18 May 2022,

<https://asic.gov.au/about-asic/news-centre/find-a-media-release/2022-releases/22-111mr-federal-court-finds-timeshare-company-ultiqa-failed-consumers-with-multiple-breaches-of-financial-services-laws/>

<sup>3</sup> CHOICE & Super Consumers Australia, 2022, “Quality of Advice Review survey”, data was collated 4 May – 23 May, 2022, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their experiences in seeking financial advice, n=1,221.

In order to examine whether there have - or have not - been significant improvements in the quality of advice as a result of recent reforms, the review needs to first gather empirical evidence. CHOICE strongly recommends that the Review request ASIC to conduct an audit of files to inform the Review process. The Review should also release an interim report for public comment before a final report is drafted.

CHOICE has three overarching recommendations to the Review to improve the quality of advice Australians receive. These are:

1. **Ban all remaining conflicts of interest in the advice industry.** Conflicts arising from existing commissions and asset-based fees lead to advisers recommending products that are of poor value or even harmful to their clients. Many of these conflicts are only permitted as a result of the legislative carve-outs that were strongly criticised in the final report of the Banking Royal Commission.
2. **Retain the best interests duty.** The best interests duty and the obligation to prioritise the interest of clients are important consumer protections. These protections ensure that financial advisers are acting in the best interests of consumers, not their own. As Commissioner Hayne found, “duty to client and self interest pull in opposite directions.”<sup>4</sup> We recommend that the best interests duty remain in force and that the Australian Securities and Investment Commission (**ASIC**) be properly resourced to investigate how it is being applied and take enforcement action where it detects breaches of the law.
3. **Consider alternative models to financial advice for people seeking guidance.** The Review should consider the role of government, independent organisations and new business models in ensuring everyone can find themselves in a high quality retirement product. We encourage the Review to consider the United Kingdom’s Money and Pensions Service as an alternative model for those whose needs the private financial advice market will never be able to service.

Finally, we note that it will continue to be important for people who lose money due to poor advice to be compensated. We welcome the Government’s commitment to establish a compensation scheme of last resort (**CSLR**), which will play an important role in improving the quality of advice, by creating financial incentives for the advice industry to improve standards of practice.

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<sup>4</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, Final Report, p7.

## Recommendations

### Recommendations about the Quality of Advice Review process

In order to ensure a review process that can deliver to the intent of the Banking Royal Commission recommendation, the Review should:

1. request ASIC to conduct an audit of financial advice files before the final review.
2. release an interim report with draft findings and proposed policy proposals for public comment before a final report is drafted.

### Policy recommendations

The Review should:

3. consider solutions outside the private personal financial advice market that would be accessible for low to middle income Australians. The Review should consider the United Kingdom's Money and Pensions Service as an alternative model.
4. recommend retaining the best interests duty and related obligations as important consumer protections.
5. recommend retaining safe harbour provision until clear empirical evidence from ASIC that shows it is ineffective.
6. recommend banning all remaining conflicted remuneration in the advice industry. This includes prohibiting the following forms of conflicted remuneration:
  - a. life insurance exemptions;
  - b. general insurance and consumer credit insurance exemptions;
  - c. timeshare exemptions; and
  - d. asset-based fees.
7. recommend that the current ongoing fee arrangements that include an annual forward-looking statement of fees remain in place, with an additional requirement that any fees charged be fixed and not charged as a percentage of funds.
8. recommend that ASIC should be appropriately resourced to monitor the ongoing quality of financial advice, including a regular program of financial advice file audits and shadow shops.

## The Review must focus on assessing the quality of advice that consumers receive

The primary purpose of this inquiry should be to review the quality of financial advice that consumers receive.

This Review needs to comprehensively assess the effectiveness of measures implemented by the Government, regulators and financial services entities to improve the quality of financial advice since the Banking Royal Commission. This requires an empirical evidence base on which to form a view about the quality of advice. It would be completely contrary to the intent of the Royal Commission recommendation for the Review to form a view on quality of advice based primarily on submissions to the Review, most of which are likely to be from industry bodies.

Every ASIC review of advice case files has shown the industry is regularly in breach of financial advice laws but the last such review was a review of the quality of advice provided to superannuation members in 2019, before most legislative reforms resulting from the Banking Royal Commission came in effect.

That review found that only 49% of the files demonstrated full compliance with the best interests duty and related obligations.<sup>5</sup> Over 1 in 7 of the files assessed did not comply with the best interests duty and related obligations and there was an indication that the member was at risk of suffering financial or non-financial detriment as a result of following the advice provided.<sup>6</sup>

### An audit of advice files is needed

CHOICE recommends that the Review ask ASIC to conduct and publish an audit of advice files. This is the only way in which the Review can form a valid view on whether reforms introduced following the Banking Royal Commission have impacted the quality of advice available to consumers.

### An interim report should be released for public comment

The terms of reference invite the Review to consider issues that could have significant and long-term implications for consumer protection in the financial advice industry. Every other process that has led to significant reforms to financial advice regulation has involved extensive opportunities for public debate over policy options.

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<sup>5</sup> ASIC, 2019, REP 639 Financial advice by superannuation funds, p7.

<sup>6</sup> Ibid.

To ensure an appropriate degree of public scrutiny and debate over policy options the Review may be considering, CHOICE strongly encourages the Review to release a draft or interim report that details draft findings and potential recommendations. Stakeholders including consumer groups, regulators and industry should be provided with an opportunity to comment. This is best practice for major financial services inquiries and is a crucial step in ensuring robust policy outcomes.

**Recommendation 1:**

The Review should request ASIC to conduct an audit of financial advice files before the final review.

**Recommendation 2:**

The Review should release an interim report with draft findings and proposed policy proposals for public comment before a final report is drafted.

## Affordability must not be used as excuse for weakening consumer protections

We note the decision by the former Government to ask this review to consider affordability of advice, rather than focusing on the quality of advice as clearly recommended by the Banking Royal Commission.

Maintaining the quality of advice available to consumers, regardless of their financial means, should be the paramount consideration of the Review. Australians on low to middle incomes would not be well served by cheaper models of advice that fail to adequately consider and address their best interests. We note that empirical evidence that has been gathered by ASIC over time has repeatedly demonstrated systemic problems with the quality of advice. Lowering regulatory requirements would most likely lead to a deterioration of quality.

Even adopting some of the flawed proposals advanced by industry groups to reduce the quality and cost of advice would fail to close the affordability gap. According to research from the Financial Services Council, reducing consumer protections, such as removing the safe harbour steps and statements of advice, would lower the average cost of providing advice from around \$5,300 to \$3,500.<sup>7</sup> This is still seven times more than the \$500 an average Australian would be willing to pay for financial advice.<sup>8</sup>

Affordability barriers will always exist for many consumers when accessing professional services such as lawyers or financial advisers. The business model of paying for individual personal financial advice in a private market will always be out of reach for a significant proportion of people.

### The Review should consider alternatives to privately provided financial advice

A model similar to that of the United Kingdom's Money and Pensions Service should be considered for lower to middle income Australians. This model integrates a range of services into a one-stop-shop. The Pension Wise service gives people access to free, impartial, specialised guidance about their pension options, delivered face-to-face or over the phone. The service also provides a free, online tool to help people choose how to access their pension money, including a product comparison tool.

In establishing this model, the UK government made an explicit decision that advice should be provided by organisations that are independent and free of actual (or potential) conflicts of interest. We encourage the Review to recommend a similar model to address the needs of

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<sup>7</sup> Financial Services Council, 2021, White Paper on Financial Advice, p3.

<sup>8</sup> Rice Warner, 2020, Future of Advice, p11.



Australians whose interests can never be adequately served by the private financial advice market.

**Recommendation 3:**

The Review should consider solutions outside the private personal financial advice market that would be accessible for low to middle income Australians. The Review should consider the United Kingdom's Money and Pensions Service as an alternative model.

## The best interests duty is a crucial consumer protection that must remain as is

The best interests duty, introduced as part of the Future of Financial Advice ('FOFA') reforms, is a crucial foundation for consumer protection in financial advice. This duty mandates that a provider of advice must act in the best interests of the client in relation to the advice. Under this duty, advisors must also give priority to the interests of the client in the event of a conflict of interest when providing advice.

When consumers pay for financial advice, they expect to receive recommendations that are tailored to their individual consumer needs. Prior to the introduction of the best interests duty, what consumers often received instead was a sales pitch for the product that would provide the greatest benefit to their advisor. CHOICE strongly opposes any reforms that would dilute this obligation.

Distrust remains a significant factor dissuading consumers from seeking financial advice. In 2019, ASIC found 49% of survey participants agreed that financial advisers were more interested in making themselves rich than in helping their customers.<sup>9</sup> When CHOICE asked its supporters and members, just 34% trusted the financial advice industry to provide high quality advice.<sup>10</sup>

Many people indicated a high level of distrust in the industry as their primary reasoning for not seeking advice:<sup>11</sup>

*"I just don't trust that they will be impartial. Too many financial advisers just recommend what will give them the best commission."*

- Rasmi\*

*"I do not trust that I will be led towards products that are more to my benefit than to financial advisors interests (bank affiliations, commissions etc)."*

- Adam\*

*"I want to get advice but am concerned that I could spend significant amounts and be misled by an advisor who benefits from where my money is invested."*

<sup>9</sup> ASIC, 2019, REP 627 Financial advice: What consumers really think, p8.

<sup>10</sup> CHOICE & Super Consumers Australia, 2022, "Quality of Advice Review survey", data was collated 4 May – 23 May, 2022, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their experiences in seeking financial advice, n=1,221.

<sup>11</sup> Ibid.

- Alexandra\*

*“Not sure where to find a genuine financial adviser who will really assist our finance.”*

- Zhu\*

*“Not really sure what type of advisor to see, how to find a good one, how to even know if they're a good one.”*

- Antonia\*

*\*names are changed for privacy reasons*

Many in the industry continue to lobby to remove or water down reforms that seek to restore this trust. Consumers have good reason to remain wary whenever the industry continues to push for weaker consumer protections.

The ‘safe harbor’ provision refers to a series of specific steps that an adviser may complete to be seen to have satisfied the best interests duty. ASIC’s regulatory guidance confirms that complying with the safe harbour provision is “one way... (and)... not the only way” to satisfy the best interest duty.<sup>12</sup> Advisers can satisfy the best interests duty without relying on the safe harbour provision.

This is consistent with the Explanatory Memorandum introducing the best interests duty, which states that the safe harbour provision is:

*“not intended to be an exhaustive and mechanical checklist of what it is to act in the best interests of the client.”<sup>13</sup>*

The Explanatory Memorandum states the safe harbour provision should be viewed as the “minimum” of what is expected of advisers to discharge their obligations.

Advocates for the removal of the safe harbour provision argue that it has encouraged a ‘tick-a-box’ approach to compliance. If advisers are taking such a simplistic approach to compliance, this is strong evidence of an immature culture of compliance within the industry. It also shows a lack of willingness or ability to engage with the best interests duty, which is at its heart a very easy obligation to understand.

A more professional industry would not need safe harbour provision in order to adhere to the law. However, as the advice industry is still on the journey towards professionalisation, the safe

<sup>12</sup>ASIC, 2021 Regulatory Guide 175: Licensing: Financial product advisers—Conduct and disclosure, p.72-73

<sup>13</sup> Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, 1.25

harbour provisions are needed to set a benchmark for the conduct of advisers when applying the best interests duty.

The Banking Royal Commission found that the safe harbour provision should only be amended, or removed, once the effectiveness of recent reforms have been assessed. Without rigorous analysis by the Review and ASIC as to whether quality of advice has improved as a result of changes following the Banking Royal Commission, it would be highly risky to the community to reduce or remove this provision. The Review should gather quantitative evidence on how often the industry relies on safe harbour provisions in providing advice. It should also analyse the relationship between the use of safe harbour provisions and the quality of advice that consumers receive.

**Recommendation 4:**

The Review should recommend retaining the best interests duty and related obligations as important consumer protections.

**Recommendation 5:**

The Review should recommend retaining safe harbour provision until clear empirical evidence from ASIC that shows it is ineffective.

## Conflicted remuneration continues to drive poor outcomes for consumers

CHOICE supports a ban on all remaining forms of conflicted remuneration, including exemptions for life insurance, general insurance, consumer credit insurance and timeshare commissions. Conflicted remuneration is a benefit received by a provider of advice that may influence the advice given. The FOFA reforms introduced a ban on conflicted remuneration, with some exemptions.

To further address conflicts of interests in financial advice, CHOICE also recommends a ban on asset-based fees, and that the Review considers options to separate providers of advice from institutions that issue financial products.

When CHOICE asked members of the community about financial advice, 70% of respondents said they don't trust financial advisers that receive commissions.<sup>14</sup> Recent cases including the collapse of vertically integrated Dixon Advisory show that the problems of conflicted remuneration and ownership structures still hurt the community three years after the Banking Royal Commission. The firm's highly conflicted business model invested thousands of its customers dollars into its own high-fee, poorly performing property fund. For the thousands of people who entrusted retirement savings to Dixon Advisory, their retirement plans are now at serious risk due to its collapse.

Barbara has been impacted by the poor advice from Dixon Advisory.<sup>15</sup> When Barbara was first approached by Dixon, she was managing her own investment portfolio and invested in lower-risk, well-established companies on the Australian stock market. However, Dixon advisers recommended Barbara sell her existing shares and invest in Dixon's conflicted in-house property fund. As a result of this advice, Barbara estimates she lost at least \$600,000. This is her experience:

*"They groomed me for a couple of years, and then they moved in, sending me recommendations and backing them up with phone calls. They wouldn't hang up until they got a yes.*

*"I ended up losing all my confidence in my own investment ability and handed it all over to them, because they were the professionals. They just exploited the Daryl Dixon factor. He was held up as the guru of superannuation and wealth management.*

<sup>14</sup> CHOICE & Super Consumers Australia, 2022, "Quality of Advice Review survey", data was collated 4 May – 23 May, 2022, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their experiences in seeking financial advice, n=1,221.

<sup>15</sup> CHOICE 2022, Can you trust your financial adviser?

*“I’d get an information sheet, a recommendation, and then they’d follow up with a phone call. They used every tactic in the book. They wouldn’t get off the phone with you. It was like they knew something that you didn’t. It was scammer talk when I think about it now, but you don’t see it as scammer talk when you’re talking to professionals. When I think now how stupid I was. I had all my blue chips, and they trashed them.”*

Barbara filed a complaint with AFCA in January 2022 but it’s also on hold because Dixon Advisory entered into voluntary administration in January.

Commissioner Hayne said this Review should be considering stories such as these to decide whether the regulatory regime is adequately protecting consumers from conflicts. The Banking Royal Commission correctly identified that conflicted remuneration will always, by definition, raise the risk of poorer quality advice because it fundamentally misaligns the incentives of advisers from the interests of consumers.<sup>16</sup> Cases such as Dixon make it clear that these conflicts cannot be managed and must instead be abolished.

It has been almost ten years since FoFA reforms first tried to ‘manage’ some existing conflicts. Industry has had more than enough time to restructure in response to these reforms and develop models for remuneration that do not rely on these conflicts.

## Life insurance exemptions should be removed

CHOICE recommends removing the exemption for life risk insurance products. Due to widespread industry lobbying, commissions on these products were exempted from the ban on conflicted remuneration that was introduced in the Future of Financial Advice reforms. These commissions create a perverse incentive for advisers to sell life insurance to people that are not suitable for their needs.

A 2014 ASIC review of retail life insurance found systemic problems within the industry.<sup>17</sup> 37% of advice failed to prioritise the needs of the client and comply with the law. High upfront commissions were strongly correlated with poor advice; 45% of advisers who were paid through up-front commissions failed to comply with the law. The statutory carve-out for life insurance commissions creates misaligned incentives and results in poor consumer outcomes. This research into life insurance advice found the way an adviser is paid (e.g. under an upfront commission model compared to a hybrid, level or no commission model) has a statistically significant bearing on the likelihood of their client receiving advice that is not in their best interest.

<sup>16</sup> Australian Government, 2019, Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, p 97.

<sup>17</sup> ASIC, 2014, Report 413: Review of retail life insurance advice, pp. 5-7.

CHOICE acknowledges the legislative changes to both cap upfront commissions and to introduce clawbacks.<sup>18</sup> The reforms are an improvement from previous arrangements, however, they do not remove the conflict – they simply make it slightly less profitable. Given the evidence of consumer harm related to commission-based sales, commissions need to be permanently banned, as they are for other types of financial advice. As also recommended by the Banking Royal Commission, ASIC should be resourced and directed to use its regulatory power to introduce a glide path to zero for the removal of life insurance commissions, with the aim of giving advisers a reasonable timeframe to develop new revenue streams while protecting consumers from further exploitation.

## General insurance and consumer credit insurance exemptions should be removed

CHOICE recommends the removal of the exemption for monetary and non-monetary benefits for general insurance and consumer credit insurance. The Banking Royal Commission revealed that these carve-outs lead to poor consumer outcomes, with consumers being sold into general insurance that is inappropriate to their needs.

ASIC's 2019 review of consumer credit insurance ('CCI') found that sales practices and product design are still delivering poor outcomes for consumers. For the financial years 2011-18, ASIC found that for CCI sold with credit cards, consumers received only 11 cents in paid claims for every dollar paid in premiums.<sup>19</sup> In its review of the insurance market in northern Australia, the ACCC recommended the exemption for general insurance be removed as it gives rise to unacceptable conflicts of interests.<sup>20</sup>

As with other forms of conflicted remuneration, as long as advisers are incentivised to sell such products, consumers will continue to experience poor outcomes.

## Timeshare commissions should be banned

CHOICE recommends a ban on timeshare commissions. Under the *Corporations Act 2001* ('the **Corporations Act**'), monetary benefits given for advice that relates to timesharing schemes are not considered conflicted remuneration.<sup>21</sup>

Commissions in the timeshare industry encourage high pressure sales tactics that trap consumers in poor value products. Timeshare salespeople have an obligation under Section 961B of the Corporations Act to act in the best interests of customers. Despite this, some salespeople who are financial advisers sell people into complex timeshare contracts that can

<sup>18</sup> ASIC Corporations (Life Insurance Commissions) Instrument 2017/510.

<sup>19</sup> ASIC, 2019, REP 622 Consumer credit insurance: Poor value products and harmful sales practices, p3.

<sup>20</sup> ACCC, 2020, Northern Australia Insurance Inquiry Final Report, p xxii, Recommendation 19.1,

<sup>21</sup> Corporations Act 2001, REG 7.7A.12C.

last over 60 years and can cost over \$450,000.<sup>22</sup> CHOICE is concerned that the advice provided to people attending timeshare presentations is of poor-quality and very seldom is in their best interests.

A 2021 CHOICE survey of 350 timeshare holders found 18% of survey respondents reported being subject to high-pressure sales tactics or being misled by salespeople about their timeshare membership.<sup>23</sup> Between 2018 and 2019, ASIC shadow shopped a sample of personal advice on timeshare schemes provided to consumers, and found “high levels of non-compliance with the best interests duty and related obligations.”<sup>24</sup>

In the same shadow shop, ASIC also found that not a single consumer who attended a timeshare presentation recognised that they were receiving financial advice. No participants could recall receiving any advice as to whether the product aligned with their objectives, financial situation and needs.

Timeshare company Ultiqa was recently found to have breached multiple financial services laws. The Federal Court revealed sections of the sales manual used at Ultiqa's timeshare seminars. It showed a harmful sales culture that was focused on maximising sales using high-pressure tactics. One section read:

*"Once your client is on the Sales Deck they come to the grim realisation that this is a sales environment and what is going through their mind is 'How can we get out of here?'; and, if you give them the chance, they will. DO NOT GIVE THEM THE CHANCE! Do everything you can do to amuse, interest, excite, relax, humour, flatter and if necessary cajole your clients into staying." <sup>25</sup>*

Consumers will continue to be targeted by these sales tactics as long as timeshare salespeople continue to receive commissions for selling products. A ban on conflicted remuneration is a critical step in reducing consumer harm in this industry.

## Asset-based fees should be banned

CHOICE considers the removal of asset-based fees to be essential to improving the quality of financial advice. Asset-based fees are calculated as a percentage of funds under management. These fees obscure the true cost of the service provided, and share many of the harmful

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<sup>22</sup> CHOICE, 2018, “Are holiday timeshare resorts worth it?”, accessed on 20 May 2022, [www.choice.com.au/shonky-awards/hall-of-shame/shonkys-2018/marriott](http://www.choice.com.au/shonky-awards/hall-of-shame/shonkys-2018/marriott)

<sup>23</sup> CHOICE, 2021, “THE TIMESHARE TRAP”, accessed on 20 May 2022,

<https://www.choice.com.au/consumer-advocacy/policy-submissions/2021/may/super-complaint-to-asic-about-the-timeshare-industry>

<sup>24</sup> ASIC, 2019, REP 642 Timeshare: Consumers' experiences, p6.

<sup>25</sup> ASIC, 2022, 22-111MR Federal Court finds timeshare company Ultiqa failed consumers with multiple breaches of financial services laws, accessed 18 May 2022,

<https://asic.gov.au/about-asic/news-centre/find-a-media-release/2022-releases/22-111mr-federal-court-finds-timeshare-company-ultiqa-failed-consumers-with-multiple-breaches-of-financial-services-laws/>



characteristics of commissions or ongoing service arrangements. These fees bear no relationship to the work actually done by the financial adviser or the quality of that work.

Asset-based fees also create conflicts of interests that may encourage the adviser to give poor quality advice. They discourage strategic advice, such as personal debt reduction, like paying down a home loan or credit card, for which the adviser would not earn a fee, towards recommendations that acquire products in which an adviser can extract an asset-based fee. Once established, asset-based fees do not provide an incentive to provide ongoing services to the client, because the financial adviser is paid regardless. They have consistently been a source of poor consumer outcomes for decades, and have driven disastrous business models.

Asset-based fees also allow firms to ‘clip the ticket’ of their client’s hard earned-savings at multiple stages in the process. Consumers can be hit with an asset-based fee when they engage with an adviser. They are hit with an asset-based fee when they access an investment platform. They are hit with an asset-based fee for each product they invest in on that platform. Further, asset-based fees penalise those with more savings. With a “platform administration fee” of 0.75%, an individual with \$200,000 invested in the platform would pay double the fees paid by another individual with \$100,000 invested in the exact same platform. Asset-based fees in financial advice should be banned, and be replaced with fixed fees for service.

**Recommendation 6:**

The Review should recommend banning all remaining conflicted remuneration in the advice industry. This includes prohibiting the following forms of conflicted remuneration:

- a. life insurance exemptions;
- b. general insurance and consumer credit insurance exemptions;
- c. timeshare exemptions; and
- d. asset-based fees.

## Fees need to be transparent, fixed and forward-looking

CHOICE strongly supports the current ongoing fee arrangements, which require financial advisers to provide an annual forward-looking statement of service they will provide to consumers. If a service is truly of value, a consumer should have no qualms about continuing to procure it.

It is evident from the widespread occurrence of fees-for-no-service that financial advice licensees and advisers are not able to be trusted to actually provide services, without a clear legal requirement to confirm their clients consent. Unregulated, ongoing arrangements create an incentive for advisers to avoid or minimise contact with clients - the less time and effort an adviser spends on a customer, the greater the financial payoff. This is exemplified in evidence from the Banking Royal Commission where for BW Financial Advice Limited, a subsidiary of the Commonwealth Bank, the “mere offer of an annual review was sufficient for the fee to be charged.”<sup>26</sup>

One CHOICE respondent shared their experiences with being charged ongoing fees for minimal service:<sup>27</sup>

“My wife and I had experience with a NAB advisor who wasn't doing due diligence with our life saving investments, but who was collecting significant annual fees for them over years. All he was doing was sending out glossy annual generalised (global type) reports that had little relevance to our specific investments.

“When we took him to task he said that we should have [been] exercising closer management of our portfolio. What were we paying him for? In effect at no time did he take responsibility for our funds poor performance and never recommended taking any action in relation to them.

“He tended to use the rather stale mantra of financial advisors , 'don't make any changes to your investments, everything will come good in time'. We see this as a cop out that promotes non-action by advisors. As a result over some years we lost thousands of dollars.”

*Leo and Isla\**

*\*names are changed for privacy reasons*

<sup>26</sup> Australian Government, 2019, Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, p 97.

<sup>27</sup> CHOICE & Super Consumers Australia, 2022, “Quality of Advice Review survey”, data was collated 4 May – 23 May, 2022, the sample is self-selecting from an online survey asking CHOICE supporters and the general public to share their experiences in seeking financial advice, n=1,221

Without a clear statement that outlines a forward-looking statement of services, some advisers are incentivised to do as little work as possible. Fees must be transparent, clearly communicated and charged in exchange for a service that is of value.

**Recommendation 7:**

The Review should recommend that the current ongoing fee arrangements that include an annual forward-looking statement of fees remain in place, with an additional requirement that any fees charged be fixed and not charged as a percentage of funds.

## ASIC should be adequately resourced to oversee the advice industry

ASIC plays an important role in regulating the financial advice industry and ensuring consumers receive high-quality advice. ASIC's reporting is highly valuable in understanding whether the industry is working in consumer's interests.

Properly equipped, fast acting regulators are best positioned to play a harm prevention role in the financial services sector. ASIC is at its best when it is able to monitor the industry as a whole, discouraging bad practices broadly, rather than chasing bad actors after they have already impacted consumers' livelihoods.

ASIC's shadow shop and reviews of advice files were instrumental in establishing the evidence base of harm needed for the Future of Financial Advice reform. Shadow shops are an important tool used across a wide variety of industries to independently verify the quality of service that consumers receive. Over the past 35 years, CHOICE has conducted a number of shadow shops of the financial advice industry.

- In 1987, CHOICE conducted a shadow shop of financial advisers and raised concerns about vertical integration as we saw a clear preference for advisers to recommend lower quality products of its parent bank.<sup>28</sup> For example, a Westpac adviser only recommended Westpac financial products.
- In 1990, CHOICE conducted another shadow shop of the advice industry.<sup>29</sup> The investigation found one adviser suggested borrowing another \$50,000 to "make her portfolio more substantial." Another adviser recommended a property trust that was run by a subsidiary of the adviser's parent company.
- In 1995, CHOICE asked 23 consumers to receive financial advice and document their experience.<sup>30</sup> They were each asked to visit three different financial advisers and get a financial plan. An expert panel scrutinised the quality of advice consumers received. Less than 10% of the advice was classed as "good", with 25% being ranked as "substandard."
- In 1998, 37 consumers visited 100 financial planners for financial advice.<sup>31</sup> They asked for a written, comprehensive financial plan and an expert panel assessed the advice. 18% failed the shadow shop, and only 6% achieved the top result of "very good."

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<sup>28</sup> CHOICE, 1987, 'How to choose an investment adviser' and 'What the advisers told CHOICE'.

<sup>29</sup> CHOICE, 1990, '(In)vested interests: How independent and objective is your financial advisor?'.

<sup>30</sup> CHOICE, 1995, 'Take my Advice?'.

<sup>31</sup> CHOICE, 1998, 'Who do you trust with your life savings?'.

- In 2003, CHOICE conducted a joint shadow shop with ASIC.<sup>32</sup> 53 consumers visited three planners each. 27% of the advice was graded “poor” or “very poor”, 24% of plans were “borderline”, and 29% of plans were “OK.” One adviser recommended the client switch all her money out of her existing funds into one offered by the planner’s own company. This would have cost the individual up to \$17,000 to switch.

From 2003, ASIC took over the process of shadow shopping but it has been over a decade since ASIC last conducted such an exercise. In the last shadow shop in 2011, ASIC found that 39% of retirement advice provided was poor and only 3% received good quality advice.<sup>33</sup>

This review should consider recommending that ASIC be resourced to conduct monitoring the quality of advice consumers receive on an ongoing basis, such as regular shadow shops, and should have enough resourcing to undertake this.

**Recommendation 8:**

The Review should recommend that ASIC should be appropriately resourced to monitor the ongoing quality of financial advice, including a regular program of financial advice file audits and shadow shops.

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<sup>32</sup> CHOICE, 2003, January/February, ‘Too many poor plans’.

<sup>33</sup> ASIC, 2012, REP 279 Shadow shopping study of retirement advice, p.8.