maurice blackburn lawyers

8 June 2022

Secretariat, Quality of Advice Review
Financial System Division
Treasury
Langton Cres
Parkes ACT 2600

By email: AdviceReview@treasury.gov.au

Dear Madam/Sir,

We welcome the opportunity to provide feedback in relation to the Quality of Advice Review.

Please do not hesitate to contact me and my colleagues on 07 3014 5051 or at JMennen@mauriceblackburn.com.au if we can further assist with Treasury's important work.

Yours faithfully,

Josh Mennen
Principal Lawyer
MAURICE BLACKBURN

Submission in Response to the Issues Paper for the Quality of Advice Review

June 2022

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Introduction

Maurice Blackburn Pty Ltd is a plaintiff law firm with 33 permanent offices and 30 visiting offices throughout all mainland States and Territories.

Our Superannuation, Insurance and Financial Advice Disputes practice has represented and assisted thousands of claimants for over 20 years. We have the largest practice of its kind in Australia and currently have approximately 125 staff nationally working in the team.
At any one time we provide legal assistance to approximately 3500 to 4000 clients.

A major part of this work involves providing comprehensive advice and representation in cases involving often egregious and negligent behaviours on the part of financial service providers. We witness first-hand the ramifications and impacts of poor corporate behaviours by financial service providers - including those who provide financial advice - which can create significant financial hardship in our clients' lives.

Our Submission

The Issues Paper tells us:[1]

> *The Review is born out of the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission). In particular, the Review addresses Recommendations 2.3, 2.5 and 2.6, which called on the Government to assess the effectiveness of measures to improve the quality of financial advice following their implementation.*

Recommendations 2.3, 2.5 and 2.6 reflect Commissioner Hayne's strong desire that consumer protections, guarding against Financial Advisors prioritising their own interest over those of consumers, be enacted promptly – and that the implementation of those protections be reviewed by the end of 2022.

In setting the Terms of Reference for that review, the previous Government framed it thus:

> *2. The Review will consider how the regulatory framework could better enable the provision of high quality, accessible and affordable financial advice for retail clients. In particular, it will investigate:*
>
> > *2.1. Opportunities to streamline and simplify regulatory compliance obligations to reduce cost and remove duplication, recognising that the costs of compliance by businesses are ultimately borne by consumers and serve as an impediment to consumers' access to quality advice;*
> >
> > *2.2. Where principles-based regulation could replace rules-based regulation to allow the law to better address fundamental harms and reduce the cost of compliance;*
> >
> > *2.3. How to simplify documentation and disclosure requirements so that consumers are presented with clear and concise information without unnecessary complexity;*

[1] p.4

2.4. Whether parts of the regulatory framework have in practice created undesirable unintended consequences and how those consequences might be mitigated or reduced

The Terms of Reference have thus expressed Hayne's consumer protection focused recommendations through an industry lens.

This is also evident in what the previous Government stipulated that the review should *not* make recommendations on, including:[2]

- The professional standards of financial advisers,
- The disciplinary and registration systems for financial advisers,
- The definitions of 'retail client', 'wholesale client', and 'sophisticated investor', and
- Financial services redress arrangements.

This, we suggest, has permeated the framing of the Issues Paper, away from 'are consumers now better protected by recent interventions', to 'what impact have recent interventions had on financial advisers'.

This is evidenced by the fact that at least 68 of the questions in the Issues Paper can only by addressed by financial advisers. There are very few questions where the review seeks the input of consumers (or their representatives) on whether recent interventions have improved the quality of advice. In keeping with the broader outputs of the Royal Commission, it is vital that consumer voices are heard in this review.

We would have preferred such a broad-ranging inquiry to have an equal focus on what changes can be made to ensure better quality advice is offered to consumers. Sustainability of the sector is important, but if the quality of the advice product is not there (i.e. the process is not consumer-focused), then the industry will fail. Optimised pricing arrangements are no substitute for fit-for-purpose advice through quality financial products.

With this in mind, Maurice Blackburn has provided below our input in relation to some of the questions from the issues paper. Our perspectives are drawn directly from the lived experience of consumers who have found themselves to be victims of the poor corporate behaviours of financial advisers, and we have restricted our responses to those questions which allow for that perspective.

It remains our fervent hope that the incoming Government will enforce a more client-focused approach to implementing the Hayne recommendations.

[2] Derived from Terms of Reference, section 6

Responses to Issues Paper Questions

4.1 Types of Advice

General and Personal Advice

Related questions from the Issues Paper:[3]

- How should the different categories of advice be labelled?

Maurice Blackburn believes that the term 'general advice', in its current use, is a misnomer which can (and often does) lead to confusion and poor financial outcomes for consumers.

We note that this concern is shared by the Financial Planning Association of Australia, which is quoted as saying:

> *It has long been our contention at the FPA that the Corporations Act must be amended to uncouple the words "general" and "advice". In our view, if it's "advice" in any form, it is tailored to your specific circumstances. Otherwise, it's simply "general information". The terms "financial advice" and "financial product advice" should be exclusively married with "personal advice" in the context of financial planning and money matters.*[4]

In considering any change to the term itself (e.g. renaming it 'general information', as is sometimes suggested), it is important to appreciate that this alone will be insufficient in dealing with the problems with the practical circumstances in which advice is provided, which go beyond semantics.

Accordingly we submit that in differentiating 'personal advice' and 'general advice', the test should expressly be based on the consumer's subjective belief as to whether the advice is tailored. i.e. that the advice takes into consideration their personal circumstances.

This is because, in assisting consumers who have suffered losses due to poor advice, we often see factual and legal disputes around the extent to which the advice was tailored to the knowledge level of consumer as well as the issue of the consumer's perception of what they are receiving.

It is not unusual for financial service providers to attempt to argue that they were not providing personal advice as defined under the *Corporations Act*.

Often, in our experience, the disclosure of 'general' or 'limited scope' (see below) advice is provided as a written warning without any discussion as to the implications, or appears in the final document. This box ticking approach often results in the consumer being unable to process what it actually means.

We believe that it is important that the adviser, who is responsible for clearly setting the parameters of the retainer does so, and ensures the nature of the advice is properly documented.

Maurice Blackburn therefore advocates for the following marked changes to be made to s.766B(3) of the *Corporations Act* in order to provide clarity that it is the consumer's

[3] p.13
[4] Ref: https://thewest.com.au/business/your-money/its-not-ok-to-be-general-about-financial-advice-ngb881158371

reasonable belief, rather than the adviser's intent, that is the key determinant for deciding whether personal advice has been provided:

> *(3) For the purposes of this Chapter, personal advice is financial product advice that is given or directed to a person (including by electronic means) in circumstances where:*
>
> *(a) the person receiving the advice reasonably believes that the provider of the advice has considered one or more of the person's objectives, financial situation and needs (otherwise than for the purposes of compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 or with regulations, or AML/CTF Rules, under that Act); or*
>
> *(b) a reasonable person might expect the provider to have considered one or more of those matters.*

It is submitted that this view accords with the general law insofar as the courts have adopted a broad interpretation of the statutory terms 'recommendation' and 'statement of opinion' (the statutory terms in s.766B(1)) in order to meet the statutory intention to be protective of consumers.[5]

In that regard, the High Court has recently found that the advice in issue was personal despite there being a general advice disclaimer that read: "*Everything discussed today is general in nature, it won't take into account your personal financial needs*"[6], noting that the communications with the consumers specifically related to their personal superannuation accounts.

We encourage this inquiry to explore ways to embed a due regard for the consumer's reasonable understanding of the nature of the advice into the legislation.

Limited Scope Advice

Related Questions from the Issues Paper:[7]

- Do you think that limited scope advice can be valuable for consumers?
- What legislative changes are necessary to facilitate the delivery of limited scope advice?
- Other than uncertainty about legal obligations, are there other factors that might encourage financial advisers to provide comprehensive advice rather than limited scope advice?

Many of the reforms aimed at strengthening the rules underpinning the provision of financial advice are as a direct result of critical findings by the Royal Commission, and the implementation of FOFA reforms over the past decade.

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[5] See Allsop CJ in Australian Securities and Investment Commission V Westpac Securities Administration Ltd [2019] FCAFC 187; BC201909716

[6] https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-013mr-asic-successful-against-westpac-subsidiaries-appeal-to-high-court/. See summary: https://www.listgbarristers.com.au/publications/westpac-v-asic-high-court-vindicates-asics-position-on-personal-financial-advicewestpac-v-asic-high-court-vindicates-asics-position-on-personal-financial-advice#:~:text=ASIC%20brought%20a%20civil%20penalty,giving%20of%20financial%20product%20advice%3B&%20text=that%20Westpac%20had%20breached%20its,and%20fairly%20(s%20912A).

[7] p.15

The Royal Commission heard numerous case studies where consumers had fallen victim to poor financial advice, offered by unqualified people, or as a result of compromised motivations for advisors.

Maurice Blackburn welcomes such reforms. We believe, however, that the need to raise ethical and behavioural standards should not be restricted to the provision of complex advice.

Even though the nature of 'limited scope advice' may not be complex, the impacts on the consumer of getting it wrong can be devastating.

Following the Global Financial Crisis (GFC) several remediation schemes were established to compensate consumers for losses due to inappropriate advice. In assisting consumers in navigating these schemes, we were often met with a defence that the advice was 'general' or 'limited', even where the consumer believed it was bespoke for their personal circumstances.

We note that ASIC was very much aware of these issues at the time. Speaking at a media conference in relation to Macquarie Equities Limited's (MEL) advice and record keeping failures in 2014, the then ASIC deputy chairman Mr Peter Kell said the regulator had found examples of MEL's 'failure to demonstrate reasonable basis for the advice provided to clients'.

> *We were concerned about whether there were adequate risk policies and processes and controls in place. We found client files not actually containing the required statement of advice.*[8]

Ironically, financial advisers used their own failure to generate and retain advice material to support this general or limited advice defence (often unsuccessfully as demonstrated by the many post GFC Financial Ombudsman Service (FOS) Decisions on this issue[9]).

One area we believe Treasury should explore as part of this review is giving consideration to the difference between a consumer's need for financial advice and their need for financial counselling. If a consumer cannot afford financial advice - even limited advice - maybe it's not what he/she actually needs. This of course requires an appropriately supported and funded financial counselling sector, in accordance with the recommendations of the leading report: *Countervailing Power: Review of the coordination and funding for financial counselling services across Australia*[10].

Perhaps a possible outcome of this review could be to consider how guidance could be offered to financial service providers on when and how to refer a client to specialist financial counselling services, and the benchmarks that determine when such a referral is deemed to be in the consumer's best interest.

In short, from our experience, we do not believe that the financial services market has had time to make the necessary cultural adjustments to satisfy the new rules – so any proposed relaxing of the rules should be viewed cautiously as it may be counter-productive.

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[8] https://www.moneymanagement.com.au/news/financial-planning/asic-highlights-macquarie%E2%80%99s-advice-and-record-keeping-failures

[9] Eg Case number: 200542, 20 September 2011, paras 40-45: https://service02.afca.org.au/CaseFiles/FOSSIC/200542.pdf

[10] https://www.dss.gov.au/communities-and-vulnerable-people-programs-services-financial-wellbeing-and-capability/release-of-the-government-response-to-the-countervailing-power-review-of-the-coordination-and-funding-for-financial-counselling-services-across-australia

Maurice Blackburn calls on Treasury to resist calls to further water-down hard-won consumer protections. We perceive current attempts at achieving carve-outs for financial advisors - under the guise of COVID responsiveness or red-tape reduction - as merely attempts to wind back consumer-focused commitments made in response to the considered recommendations of the Royal Commission.

We urge Treasury to at least recommend retaining the current regulatory requirements protecting both complex and limited scope advice. Failure to perceive the recommendations of the Royal Commission as the baseline for consumer-focused service would amount to a failure to learn the lessons of the past including those exposed by the Royal Commission.

Maurice Blackburn submits that the provision of any 'advice' no matter how limited, should be subject to robust, prescriptive regulation aimed at ensuring consumers are clearly aware of the scope of the advice, aware of the remuneration arrangements in place including any commissions payable, warned of the consequential limitations and referred on where appropriate.

We have confidence that the competitive and sustainable financial services market will find ways to provide good quality and affordable advice based on these principles.

This, however, will only happen once the industry has fully absorbed the implications of the Royal Commission, and made the necessary cultural changes to ensure consumer best interest is central to service provision – both because they have to, and because it's the right thing to do.

4.2 Best Interests and Related Obligations

The Issues Paper tells us:[11]

> *The Review is interested in the views of stakeholders on whether the safe harbour provides benefits to consumers or providers of advice, noting that Recommendation 2.3 of the Financial Services Royal Commission called for safe harbour to be repealed unless a clear justification could be identified.*

We draw the review's attention to the judgment in ASIC v NSG [2017][12] wherein both parties accepted that a financial services provider may be able to satisfy the best interests duty in s.961B(1) even though they do not fall within s.961B(2).

Specifically, the court stated:

> *There was, at least, a difference in emphasis between the parties as to the interaction between the primary provision, in s 961B(1), and the 'safe harbour' provision, in s 961B(2). However, ultimately, in the course of oral submissions, there did not appear to be any significant difference between the parties. It was accepted by ASIC that (as submitted by NSG) a person may be able to satisfy the best interests duty in s 961B(1) even though they do not fall within the 'safe harbour' of s 961B(2). The difference in emphasis was that ASIC contended that, in a "real world" practical sense, s 961B(2) was likely to cover all the ways of showing that a person had complied with s 961B(1) and, in this way, a failure to satisfy one or more of the limbs of s 961B(2) is highly relevant to the Court's assessment of compliance with the best interests duty.*

[11] p.17
[12] Australian Securities and Investments Commission v NSG Services Pty Ltd [2017] FCA 345 at [18]

Maurice Blackburn urges caution in introducing any changes that could have the effect of narrowing the application of the best interests duty, in terms of process as well as outcome.

4.3 Conflicted Remuneration

Related Questions from the Issues Paper:[13]

- To what extent has the ban on conflicted remuneration assisted in aligning adviser and consumer interests?
- Has the ban contributed towards improving the quality of advice?

In our experience, the FOFA reforms significantly ameliorated the previously staggering volume of poor consumer outcomes related to investment advice, which had, up until FOFA and especially arising out of the GFC, been driven by widespread cross-selling and other conflicted remuneration incentives.

Having said that, we remind the inquiry that the problems with conflicted remuneration which were mitigated by the FOFA reforms were not the only enablers of inappropriate service delivery. Other forms of incentives to recommend certain products over others still exist. These include KPIs, bonus structures and other staff performance incentives tilted towards particular product sales.

Advisers may also be incentivised to over index a consumer's investment risk tolerance due to asset percentage-based fee structures, which remain a staple part of many Licensees' business models. These arrangements remain a moral hazard in that they offer the adviser an upside for poor advice without any equivalent downside if the strategy fails.

Such motivators continue to promote sales of products regardless of the consumer's needs and deserve attention by this inquiry to ensure appropriate safeguards are in place to protect consumers.

Moving onto life insurance advice, the exemption from the FOFA conflicted remuneration ban continues to be problematic for consumers, resulting in failed risk strategies.

Maurice Blackburn is concerned that commission structures are still central to issues related to life insurance advice, most notably churning practices (where advisers unnecessarily rewrite their customers' policies in order to earn commissions).

This has been ameliorated somewhat by:

- the Life Insurance reform legislation[14] which has capped commissions and applied clawback disincentives for policy churning behaviour;

- large banks exiting wealth management thereby reducing the focus on pushing in-house insurance products where it is not best suited to the consumer's needs, along with the expansion of APLs; and

- the introduction of self-regulated APL standards such as the FSC Standard No. 24 which requires that the APL of a Licensee with FSC membership must contain the choice of 3 or more life insurance providers.[15]

[13] p.21
[14] https://treasury.gov.au/consultation/life-insurance-reform-legislation.

While LIF reforms have reduced commission caps, the fact that commissions still exist, which taper off, will always create a moral hazard, encouraging advisers to re-write their customer insurance book – a practice that is often accompanied by inadequate disclosure advice leading to policy avoidances and declined claims, and often triggering AFCA and court proceedings against Licensees for damages representing the insurance arrangements that would have been paid out if the switching advice has not occurred.

This in turn exacerbates Licensees' operating costs due to professional indemnity deductibles/premiums, AFCA levies and the anticipated Compensation Scheme of Last Resort (CSLR) levies.[16]

The clawback mitigations are an essential element of the disincentives however these are only live for two years against an advice relationship that may span decades. Stakeholders would benefit from access to transparent, up-to-date data on the rate of clawbacks, in order to make an assessment as to whether the clawbacks are fulfilling their role as a disincentive to churning.

Furthermore, churning practices are not caused or eradicated solely through commissions structures but are associated with an employee advisers' targets and other performance indicators outside the scope of the Life Insurance reform legislation.

Likewise, objective data as to the scope of use and effectiveness of APL self-regulation should be published for consideration in any reform discussion. The obvious risk of this approach is that the Licensee may notionally hold a larger APL menu than it utilises in practice.[17]

Further safeguards should be introduced to ensure that advisers are genuinely sourcing the market for fit-for-purpose products to meet their best interest duties and referring on where they lack the expertise to advise on the consumer's existing or appropriate product. To this end, we urge Treasury to consider regulations for minimum quotas for the use of a blend of products contained on expansive APLs.

End Note

The themes and examples discussed above illustrate the broader thrust of our submission: that better, consumer-centric controls focused on the quality of advice at the front end will help prevent the threat of controversy, cost, and potential for collapse for advisers at the back end of the consumer journey.

It has been encouraging to see the growing number of purely fee-for-service advisors who have not only survived but thrived post FOFA. This structure has helped rebuild community trust as they focus on sourcing the best available products for their clients' specific needs, circumstances and objectives without the empirically proven perils of conflicted incentives and narrow product offerings.

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[15] E.g. FSC Standard No. 24: Life Insurance Approved Product List Policy: https://www.fsc.org.au/web-page-resources/fsc-standards/1523-24s-apl

[16] See for example churning cases of *Commonwealth Financial Planning Ltd v Couper* [2013] NSWCA 444 and *Swansson v Harrison & Ors* [2014] VSC 118.

[17] ASIC's research confirms that even where APLs are broadened, the majority of customers are still likely to be directed into a narrow set of preferred (often in-house) products. ASIC's data is consistent with Roy Morgan research, which found that over a three-year period, these dealer groups allocated an average of over 70% of their sales to their own products (https://www.roymorgan.com/~/media/files/papers/2010/20101004.pdf?la=en).

While this innovative approach may decrease their profits in the short term, it will distinguish them from their conflicted peers, thus helping them gain market share in the longer term as vigilant consumers seek greater integrity and transparency.

Finally, we find it difficult to believe that the Terms of Reference to this inquiry limited the Review Team's capacity to seek input in relation to:

- The professional standards of financial advisers,
- The disciplinary and registration systems for financial advisers,
- The definitions of 'retail client', 'wholesale client', and 'sophisticated investor', and
- Financial services redress arrangements.

These are fundamental to understanding the impacts of recent legislative changes on the quality of advice provided.