SUPERANNUATION CONSUMERS' Centre

Submission to the

Financial System Inquiry

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1. Summary

This submission seeks to describe some of the experiences of end users of the financial system, in particular superannuation consumers. It aims to inform the inquiry's recommendations including meeting user need by way of appropriate financial products and services.

Our conclusion is that t**he broad framework of Wallis has worked well, with the exception of the disclosure regime, which we argue needs a fundamental rethink.**

The limitations of disclosure as a policy tool came close to unravelling the financial system during the GFC.

Disclosure relies on the notion of rational actors but since the Wallis inquiry we have learned that consumers' capacity to make rational choices is limited and in some circumstances very limited. **We think behavioural economics should supplant the concept of rational actors in the philosophy and practice of regulation**.

A **new philosophy of regulation** is needed to acknowledge that:

1) consumers use a series of short cuts to make decisions that are not consistent with the rational actor theory; and
2) market forces drive market participants to exploit this, which produces outcomes that benefits companies over consumers.

Regulators need a broader toolkit that incorporates **the learnings of behavioural economics** and allows them to:

- control the format and framing of information
- the choice environments
- product features and distribution mechanisms.

Complexity: Since Wallis complexity has emerged as an issue critical to stability of the financial system. The GFC showed that complexity is dangerous not only to the stability of individual financial systems, but to the global economy. Moreover **complexity undermines the capacity of the demand**

side to drive markets. We urge the inquiry to **consider the deleterious effects complexity has on stability, consumer confidence, competitive markets and consumer welfare.**

Competition: Complexity is impeding competition but so too is the rise of huge conglomerate financial institutions in part powered by big data. Huge institutions can deliver efficiencies of scale and attractively bundled one stop shop offerings to consumers, but at the same time these offerings are emerging as barriers to competition. The rise of big data is a force in this, but there may also be ways it could be harnessed to benefit consumers.

We urge the inquiry to **consider the anti-competitive effects of huge conglomerate institutions and unequal access to data.** We also urge the inquiry to **explore mechanisms for harnessing big data in ways to increase competition and thereby benefitting consumers.**

Consumer protection: We strongly **support the strong consumer protection framework** in financial services, but it **needs to evolve in order to deal with complexity, anti-competitive behaviour and other market failures.**

ASIC: ASIC is **an effective regulator** but its effectiveness has been **constrained by the legal and policy framework within which it operates**.

ASIC **needs a larger and more flexible toolkit** to respond effectively to a fast moving and very innovative industry.

Much of the success of internal and external dispute resolution schemes can be attributed to ASIC oversight.

External dispute resolution: External dispute resolutions schemes **have helped maintain confidence and strong relationships between consumers and financial services companies.**

However it has become apparent that market forces for complaints schemes only serves to drive down quality of services and increases consumer detriment. **We support the creation of a single whole of market EDR scheme**. This will ensure nationally consistent outcomes for consumers and industry alike; in addition to delivering efficiencies based on scale and increased consumer access through a single national brand.

Financial literacy: We think superannuation consumers would benefit from a community-run **social media platform on superannuation** to engage, educate and empower them and to complement existing government and industry financial literacy programs.

Superannuation: Consumer **trust is lower than it should be** in the superannuation system. We recommend assistance be given to fund **a dedicated, expert Centre for Superannuation Consumers as a positive contribution to restoring consumer trust.**

Compulsory super has forced all employees into investment markets, including many who would not have chosen to participate by preference, or because they lack the financial resources and/or skills and confidence to do so.

Compulsory super also **creates huge demand for financial advice** due to the **complexity of the system** and because of **lack of an agreed pathway for consumers in the retirement phase**.

We support the development of **a policy framework for the retirement phase of super that must include a default option** for those who need and or prefer it.

Given the **scale of the SMSF sector, the rapid growth** and that these funds are becoming a vehicle of choice for the mass market there is a **need to review the regulatory and policy settings** for SMSFs.

Finally there is a need to **reframe the narrative of superannuation away from wealth management and back towards retirement income**, however unglamorous the latter may seem.

Financial advisers: To mitigate risk and deal with complexity, consumers need advice intermediaries. However **the industry structure does not give consumers the confidence they need in the advice industry.**

More must be done to **facilitate the development of an independent trusted advice profession**.

Entry to the industry falls well short of consumer expectations and well short of the standards required to create an advice profession.

Professional associations could do more to encourage higher ethical and professional standards. The experience of EDR schemes has demonstrated the effectiveness of ASIC oversight of industry-based initiatives. ASIC has a policy statement on self-regulatory codes of conduct and given the

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crisis of confidence in the advice sector we think **ASIC approval of industry codes** would help build trust and confidence.

We urge the inquiry to make recommendations to **phase out the structural conflicts of interest created by vertical integration of product makers and advice givers**.

The lack of **a last resort compensation scheme is the missing piece of financial services regulatory architecture** and marks us out from UK and European jurisdictions. Uncompensated consumer loss is a contributing factor to the loss of trust in the system and the industry.

1.1 Seven key recommendations

That the inquiry:

1) Replace the concept of rational actors with human behaviour in the philosophy and practice of regulation

2) Examine the issues we have raised about the impacts on stability, competition and confidence of:

- complexity in the financial system and financial products,
- conglomeration of financial institutions and
- the rise of big data.

3) Recommend a more flexible and responsive regulatory toolkit for ASIC including capacity to control:

- the format and framing of information;
- choice environments; and
- product features and distribution mechanisms.

4) Recommend the creation of a single whole-of-market external dispute resolution scheme.

5) Recommend that assistance be provided to fund a Superannuation Consumers Centre to work with government and industry to ensure policy and products respond to consumers'

needs and to escalate consumer engagement through peer to peer social media platform focusing on superannuation.

6) Recommend the development of an overarching policy framework for the retirement phase of super that includes a default option and reframes the narrative of superannuation away from wealth creation towards retirement income stream.

7) Recommend a **review the regulatory and policy setting** for SMSFs.

8) Recommend a framework aimed at creating an independent advice profession. Elements would include:
    - higher entry level standards,
    - structural separation of advice and product manufacture
    - ASIC approval of industry codes of conduct
    - shift to professional fees rather assets-based fees
    - a last resort compensation scheme.

2. About the Superannuation Consumers' Centre

In early 2012 the consumer organisation CHOICE convened an establishment committee for a Superannuation Consumers' Centre. The committee included former Macquarie Bank CEO Allan Moss, Former Vanguard CEO and Financial Services Council Chairman Jeremy Duffield, and former ASX and ASIC Chairman Tony D'Aloisio amongst others. In August 2012 the committee took a proposal to Government to provide a one off contribution to an investment fund to provide an endowment to fund the Centre for 20 years. The Government agreed to make a $10million contribution, provided the industry matched that contribution. While a number of major funds agreed to contribute the committee did not raise the matching $10million prior to the 2013 election.

Nonetheless the Superannuation Consumers' Centre has established itself as a legal entity, has received ACNC endorsement and is operating on a limited voluntary basis. The Centre aims to make a positive contribution to restoring trust and confidence in the superannuation industry. It will work to improve the operation of the superannuation and retirement income system so that it delivers the best possible retirement income for Australian consumers. It aims to do this in two key ways:

input to Government policy and industry practice; and building a social media platform on superannuation assist, engage and empower consumers to act in their own interests. Areas of specific focus are:

1) Ensuring access to **quality advice**;
2) **Identifying retirement risk zone** issues ie the issues faced by consumers in the years either side of retirement; and
3) Highlighting the need for **policy settings and products for in the retirement phase**, in particular the need for good default products.

Given that the Centre is operating without funding and is only able to provide limited input to Government policy processes.

The business case for the Centre remains relevant. Trust and confidence in the industry is lower than it should be. This is producing suboptimal outcomes for consumers, government and industry. No one policy response will solve this problem but the establishment of a dedicated Superannuation Consumers' Centre is an important part of a suite of measures discussed in this submission. A full business case for the establishment of a Superannuation Consumers' Centre is at Appendix !.

3. Behavioural economics must inform regulatory responses

In the time since Wallis we have learned that **consumers' capacity to make rational choices is limited and in some cases very limited**. Consumer choice is rarely based on a rational assessment of hard data, rather though behavioural economics we now know that our decisions are based on a series of heuristics or short cuts that help us make sense of the world. The level of complexity is such that consumers often struggle to make rational choices, so revert to intuition.

Behavioural economics incorporates learnings from psychology, which product manufacturers, distributors and advertisers have known about for decades. What has become clear in the time since Wallis is that **the deliberate incorporation of an understanding of consumer biases into financial services products and services is distorting competition** and producing outcomes that are in the interests of the industry rather than end users of the system.

International regulators have moved to incorporate the learnings of behavioural economics into regulatory practice as a direct response to what hasn't worked over the last 20 years[1]. The new UK Financial Conduct regulator, which also has a duty to promote effective competition, has plainly indicated that it needs to understand "how information problems, consumers' behavioural errors and firms competitive strategies combine to produce market outcomes." [2]

The FCA has produced an independent piece of research canvassing the behavioural finance literature and discussing how the findings can be applied in financial regulation. The key premise is that people often make mistakes in choosing and using financial products and can suffer considerable loss as a result. **The literature identifies biases and notes market forces will not correct these, rather market forces work to deliberately exploit them.** For example the report notes how in the case of PPI add-on insurance firms could make large profits because consumers misunderstood pricing and product limitations.

In Part One, the report canvasses two key problems:

- consumer behaviour that is not consistent with the rational actor of classic market theory and
- how behaviour biases drives competition in ways that are against the interests of end users.

Part Two describes the ways in which behavioural economics can be used in the regulation ofinancial conduct. We refer you to the full FCA paper but have included some excerpts below.

[1] Human Face of Regulation speech by CEO of UK Financial Conduct Authority available at http://www.fca.org.uk/news/speeches/human-face-of-regulation
[2] Financial Conduct Authority Occasional Paper No 1 Applying behavioural economics at the Financial Conduct Authority April 2013 p 3 available at http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf

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Why are there more behavioural problems in financial services?

For a number of reasons, consumer choice in retail financial products and services is particularly prone to errors:

- **Many products are inherently complex for most people.** Financial products are abstract and intangible and often have many features and complex charging structures. This contrasts with many ordinary products where consumers can easily understand what they are getting and the product has a single, simple price. Faced with complexity, consumers can simplify decisions in ways that lead to errors, such as focusing only on headline rates.

- **Many products involve trade-offs between the present and the future.** Often people make decisions against their long-term interests because of self-control problems, e.g. borrowing excessively using payday loans.

- **Decisions may require assessing risk and uncertainty.** People are generally bad (even terrible) intuitive statisticians and are prone to making systematic errors in decisions involving uncertainty. So we often misjudge probabilities and make poor insurance or investment decisions.

- **Decisions can be emotional.** Stress, anxiety, fear of losses and regret, rather than the costs and benefits of the choices, can drive decisions.

- **Some products permit little learning from past mistakes.** Some financial decisions, such as choosing a retirement plan or mortgage, are made infrequently, with little learning from others, and with consequences revealed only after a long delay.

Which biases affect consumer financial decisions?

To identify and correct mistakes we need to be able to detect biases. The table below lists the most relevant biases for retail markets, categorising biases according to how they affect decisions:

- **preferences** (what we want);

- **beliefs** (what we believe are the facts about our situation and options); and

- **decision-making** (which option gets us closest to what we want, given our beliefs).

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Ten behavioural biases and effects in retail financial markets

Our **preferences** are influenced by emotions and psychological experiences	Rules of thumb can lead to incorrect **beliefs**	We use **decision-making** short-cuts when assessing available information
Present bias e.g. spending on a credit card for immediate gratification ***Reference dependence and loss aversion*** e.g. believing that insurance added on to a base product is cheap because the base price is much higher ***Regret and other emotions*** e.g. buying insurance for peace of mind	***Overconfidence*** e.g. excessive belief in one's ability to pick winning stocks ***Over-extrapolation*** e.g. extrapolating from just a few years of investment returns to the future ***Projection bias*** e.g. taking out a payday loan without considering payment difficulties that may arise in the future	***Framing, salience and limited attention*** e.g. overestimating the value of a packaged bank account because it is presented in a particularly attractive way ***Mental accounting and narrow framing*** e.g. investment decisions may be made asset-by-asset rather than considering the whole investment portfolio ***Decision-making rules of thumb*** e.g. investment may be split equally across all the funds in a pension scheme, rather than making a careful allocation decision ***Persuasion and social influence*** e.g. following financial advice because an adviser is likeable

How do biases affect the strategies of firms, competition and other market problems?
Firms play a crucial role in shaping consumer choices. Product design, marketing or sales processes can exacerbate the effects of biases and cause problems. Firms can respond to the different biases in specific ways (we give detailed examples in the Annex). One important response is that firms will tend to increase non-salient prices and decrease salient prices. For example, if consumers tend to underestimate how much they will spend on their credit card in the future (because of projection bias or overconfidence), firms have an incentive to offer low rates today with higher rates later. Another important response is that firms will tend to obfuscate unattractive product attributes, such as exclusions in insurance contracts.

Consumer biases thus affect competition. They can lead firms to compete in ways that are not in consumer interests, e.g. by offering products that appeal to the consumer because they play to biases. Biases can also create de facto market power in markets that might appear competitive based on the number of firms alone.

We must be mindful, however, that sometimes firms might not know that their customers are making mistakes. What looks like deliberate exploitation may actually just be firms responding to observed consumer demand without realising that it is driven by biases. Regardless of what firms know, in badly functioning markets bias exploitation may be the only way for firms to attract and retain consumers and therefore to stay in business.

Behavioural biases can also interact with other market failures like information asymmetries or externalities. They can exacerbate other problems or make regulatory interventions aimed at addressing problems ineffective or even harmful.

How can we intervene to protect consumers?

Broadly, we distinguish four main ways in which the FCA could intervene when consumers are at risk of harm because of biases:

1. **Provide information.** Require firms to provide specific information in a way that is not likely to exacerbate consumer weaknesses, or prohibit specific marketing or promotion materials or practices where they unfairly target such behavioural weaknesses, biases or mistakes.

   Example: require firms to give consumers data on past product usage or claims ratio.

2. **Change choice environment.** Adjust how choices are presented to consumers to address biases.

   Example: set the default options for products by requiring consumers to make an active decision instead of being automatically 'opted in' to buying a product.

3. **Control product distribution.** Require products to be promoted or sold only through particular channels or impose marketing restrictions in relation to certain types of clients.

   Example: require complex products to only be promoted with advice.

4. **Control products.** Ban specific product features or products that appear designed or otherwise likely to exploit consumer mistakes to their detriment, or require products to contain specific features to address the risk of detriment arising from such mistakes.

   Example: require firms to remove or limit product features, such as high exit charges.

A new philosophy of regulation is needed to acknowledge that:

3) **consumers are not always rational actors, rather they use a series of short cuts to make decisions that are not consistent with the rational actor theory and**
4) **market forces drive market participants to exploit this, which produces outcomes that benefits companies over consumers.**

Regulators need a broader toolkit to that allows them to:

- **control the format and framing of information**
- **the choice environments**
- **product features and distribution mechanisms**

4. Disclosure as we know it has reached the end of its life as a policy tool

The *Financial Services Reform Act 2001* following the Wallis Inquiry entrenched disclosure as the primary regulatory tool for dealing with market failure due to information asymmetry. In theory consumers armed with sufficient information would make rational choices, overcome conflicts and drive competitive markets to provide products that meet their needs.

Instead as Dr Sandlandt of the Australian Treasury has said: **"confused retail investors making poor financial decisions in complex markets (took) the world to the brink of global financial meltdown**"[3].

However it was not only consumers who didn't understand the system –it seems no-one really did. Not regulators, not fund managers, not hedge trader or investment banks.

In the years since Wallis the limitations of disclosure have become glaringly obvious. As Professor Kingsford Smith and her students at UNSW[4] have noted:

- Not all consumers read disclosure documents, either as a result of information overload, complexity or excessive differences in formatting making inter-product comparison hard;
- Whilst investors generally care about the disclosed material, few attempt to understand technical aspects of it;
- Even disclosure materials which identify key features of the product, when read, are not effective either because they are still not understood, or they lack information relevant to the individual, or do not affect decision-making;
- Consumers have enduring difficulties understanding particular aspects such as disclosure of fees and charges; and
- There is potential for misinterpretation of the disclosure document as something else entirely, such as a disclaimer."

In addition, as we have noted, behavioural research has underlined that consumers respond to information overload and complexity using a range of heuristics or rules of thumb to manage the decision making process which produces results that may not necessarily accord with a rational decision making process based on proper analysis of all the information.

ASIC has found "Knowledge is not enough. People don't always act in their own best interests".[5] Consumer responses to information depends on a range of factors including how the information is framed eg add-on insurances are offered to consumers via pre-ticked boxes tend to take it,

[3] Economic Roundup 1 2012 available at http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2012/Economic%20Roundup%20Issue%201/Downloads/Economic%20Roundup%20Issue%201%202012.ashx
[4] Submission to Senate Inquiry into the Performance of ASIC; Prof Dimity Kingsford Smith and students 2013
[5] Financial Literacy and Behaviour Change Report 230 March 2011 page 4 phttp://www.financialliteracy.gov.au/media/218309/financial-literacy-and-behavioural-change.pdf

consciously or otherwise. In the UK, FSA found 20% of people who had bought ad- on PPI insurance sold via a pre-ticked box didn't know they had.

Consumer research has also revealed the perversity of consumer responses to disclosure of conflicts of interest.[6] Disclosure of conflicts plays to consumers' naturally trusting response to advisers, and can result in increased trust[7]. It also creates an effect called "moral licencing" whereby advisers who disclosed conflicts might see bias advice as "fair play". [8]

As Sandlant says "confident and knowledgeable consumers would also be an enormous asset for well-functioning and efficient financial markets, if only we could figure out how to reliably produce them. The reality is that few consumers meet such high expectations, and with financial services growing in complexity faster than the capacity of regulators (let alone consumers) to stay 'one step ahead', and with consumers increasingly being given more, not less, responsibility for their own long-term financial security, governments around the world are taking a renewed interest in effective consumer financial protection.".

In particular we need to understand what drives consumer and industry behaviour and design disclosures around that. Thaler and Tucker[9] refer to emerging evidence for example that if super fund statements were to show savings in terms of retirement income streams rather than the current balance that could encourage people to save more.

To date Thaler and Tucker say too much focus has been on low-cost disclosures rather than the impact of the structure and format of disclosures.

The limitations of disclosure as a policy tool nearly brought the financial system undone in the GFC.

Disclosure as we know it has reached the end of its life as a policy tool and analysis of consumer's actual behaviour needs to drive future disclosure based consumer protection measures.

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[6] The dirt on coming clean: The Perverse effects of Disclosing Conflicts of Interest http://www.cmu.edu/dietrich/sds/docs/loewenstein/dirtclean.pdf

[7] Ibid pages 5 and 6
[8] Ibid Page 8
[9] Page

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5. Complexity

Complexity has emerged as a significant threat to the stability of the financial system. It is undermining confidence and impeding competition.

Innovation is a great strength of the financial services sector but it is also one of its weakness. Much innovation has been in highly complex structured products that few people fully understand. Complexity tends to undermine confidence in the system because some complex products have proved very dangerous and destructive of people's life savings. Complexity also impedes competition because it robs consumers of the capacity to drive markets, although properly harnessed big data may be able to assist consumers.

5.1 Complexity undermines stability

Ben Bernanke, when Chairman of the Federal Reserve, noted that good financial decision making was critical to the stability and soundness of the financial system as a whole[10]. But as we have noted complexity in financial markets confounds consumers' capacity to make good decisions and has emerged as an issue critical to the stability of the financial system. The GFC proved that it was dangerous not only to the stability of the financial system in individual countries, but also to the global economy.

The GFC exposed the danger posed by complex products that few consumers and many in industry and government did not understand: mortgage-backed securities, collateralised debt obligations, over-the-counter derivatives, credit default swaps, and mezzanine products.

As already noted "confused retail investors making poor financial decisions in complex markets (took) the world to the brink of global financial meltdown".[5] However it was not only consumers

[10] Statement available at http://www.federalreserve.gov/newsevents/testimony/bernanke20110420a.htm

who didn't understand the system –it seems no-one really did: not regulators; not fund managers; not hedge trader or investment banks.

5.2 Complexity undermines confidence especially when dangerous products explode people's retirement

We have noted that innovation is a great strength of the financial services sector but it is also a weakness. While there has been an explosion in product choice over the last 15 years there has also been an explosion of complex dangerous products that have blown up people 's retirement plans.

The GFC has not abated the flow of complex structured products offered to retail consumers and ASIC has continued to find inappropriate practices and sales of structured products to retail clients.[11]

The International Organisation of Securities Commission released a too kit for regulators on structured complex product in December last year *Regulation of Retail Structured Products*[12]. The report develops a regulatory toolkit for dealing with complex products and proposes 15 possible tools including a pre-market product approval process, standards setting for complex products, and to obligations on product issuers for the manner in which their products are sold[13] . These and other tools in the report warrant examination by the Inquiry.

There is ample evidence in Australia that complex risky products have been sold to retail investors who have not understood the nature of the product nor the risk. Opes Prime is just one example – a product/business model that few if any clients understood [14]. ASIC's report on Structured Products contains numerous others. Indeed ASIC found evidence last year that in some cases these products are sold by advisers who have not fully understood the risk.[15]

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[11] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep377-published-4-December-2013.pdf/$file/rep377-published-4-December-2013.pdf
[12] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD434.pdf
[13] Discussion of tools starts on page 21
[14] Page 56 PJC Inquiry into financial Product and Services in Australia 2009 http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf
[15] Paragraphs 72 and 73 http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep377-published-4-December-2013.pdf/$file/rep377-published-4-December-2013.pdf

5.3 Complexity undermines competition

Complexity reduces the capacity of consumers to drive markets. In financial markets such is the complexity that consumers often don't know what they have bought before or after purchase[16]. Worse still, those consumers turn to help them - financial advisers - don't always understand what they are selling as ASIC found in its recent report on Structured Products.[17] It found some advisers did not have the necessary expertise (understanding?) of the products they were recommending and consequently did not communicate the key features and risks to clients.[18]

Markets will only produce efficient outcomes that maximise consumer welfare when consumers are able to properly signal their desires to markets. Consumers can do this best with simple products that they (and their advisers) can understand. However there is a view that industry prefers to compete on complex products. Economists Admati and Hellwig in *The Bankers New Clothes* say the industry is deliberately impenetrable. "Impenetrability helps them confuse policy makers and the public."

Competition on unnecessary features – effectively bells and whistles - that consumers neither understand nor need pushes up costs and exploits consumers' inherent incapacity to exercise rational choice and distorts the market away from the needs and interests of consumers.

We urge the inquiry to fully consider the deleterious effects complexity has on stability of the system, consumer confidence, competitive markets and consumer welfare.

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[16] Trio PJC report

[17] ASIC report on Structured Products paragraphs 72 and 73 http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep377-published-4-December-2013.pdf/$file/rep377-published-4-December-2013.pdf; also it was reported after Westpoint collapsed some financial planners didn't understand what they were buying (and selling to clients)

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6. Competition issues

The rise of huge conglomerate financial institutions has the potential to deliver efficiencies of scale and one-stop shop offerings to consumers but the size of these institutions is emerging as a barrier to competition. Similarly the emergence of big data can be a force for increasing competition, but it can also undermine it.

6.1 Conglomeration

Competition often drives efficiencies from scale but it is becoming apparent in financial services that scale is also creating barriers to competition. Over the years since the Wallis inquiry banks have grown into major conglomerate institutions. The big four banks all have insurance and wealth management arms. Wealth management covers managed funds, platforms, superannuation funds and financial advice entities. They also have trading arms and brokers. Each arm uses data collected from the other to cross sell and offer attractively priced and packaged services to consumers. While this delivers some benefits to consumers it is also emerging as a significant barrier to competition.

The complexity of bundled offering makes it impossible for consumers to know which offerings suit them better and the nature of bundling makes it impossible or very difficult for consumers to break out of a less attractive part of the bundle or indeed the whole bundle without significant cost and time penalties. Additionally the complex nature of financial products, their linkages and the way in which some companies implement rules that are designed to protect consumers from fraud eg verification or signatures and or addresses that have changed since product purchase combine to making switching an almost impossible task for many consumers.

Barriers to switching banks have been articulated by CHOICE [19] Conglomeration and data-driven bundled offerings also have the result of locking consumers into particular deals or to particular institutions acting as a further break on competition.

[19] Eg in the Choice 2011 Better Banking Report
file:///C:/Users/Jenni%20Mac/Downloads/BetterBanking_Report.pdf

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This is in part driven by big data which allows endless value-added personalised offerings. While this may deliver benefits to consumers as we have noted there is evidence that companies may misuse this information to exploit customers' inherent weaknesses[20]

6.2 Big data

Big data can lead to personalised attractively bundled one-stop shop offerings. Big data gives companies powerful new insights into their most profitable customers, but as we have seen with add-on insurance[21] it also gives companies the capacity to exploit consumers' inherent weaknesses.

However what we are seeing is an increasing divergence in access to information with consumers having less and less capacity to make coherent use of the sheer amount of information and the manner in which it is presented. This is where complexity interacts with the increasingly unequal access to information to create additional risks for the financial system as a whole, consumers and smaller market participants.

Market participants, mostly larger ones, have access to much greater amounts of data than smaller players and individual consumers. The capacity of some market players to exploit their increasingly unequal access to data creates new risks to competition that we are only beginning to understand. The transfer of value that flows from high frequency trading (discussed by Michael Lewis in his new book *Flash Boys*) is one example of superior access to information enabling some market actors to gain unfair advantage. There are of course ways in which big data can deliver consumer benefit through potential valuable customisation of product offerings (as mentioned below).

One of the ways in which access to data and/or complexity can undermine consumer welfare is through the way in which it limits the effects of demand side competition. If consumers cannot work out the best offer then consumer choices will not push the market towards welfare maximisation.

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[20] As documented in the Financial Conduct Authority Occasional Paper No 1 Applying behavioural economics at the Financial Conduct Authority April 2013 available at http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf

[21] See UK FCA report on Behavioural Economics

Both the UK and US are grappling with this problem and are working on the premise that **big data, properly harnessed, has potential to increase demand side competition.**

The UK midata project[22] aims to give consumers better control of their data and encourage businesses to develop tools to enable consumers to make effective use of that data. The project is looking for voluntary data releases and initiatives in banking (accounts and credit cards), mobile phones and energy sectors but has said if information is not released voluntarily it will regulate for compulsory release. While this is a fledgling project it has **significant implications for increasing demand driven competition in the financial services sector more broadly**.

Similarly in the US the Smart Disclosure Policy[23] aims to facilitate access to consumer data in machine-readable formats to allow innovators to create tools that facilitate better consumer choice.

While in the early stages the SEC is responding to a request from its investor advisory committee to "promote the collection, standardisation and retrieval of data in machine readable data tagging formats".[24]

Thaler and Tucker[25] in the Harvard Law Review have said "a potent mix of modern technology and new government policy… may empower consumers in new ways giving them the ability to comparison shop more easily and make better choices." This will have big implications for companies that currently gain market share through "deception and obfuscation – or by taking advantage of consumer laziness". This type of disclosure may make markets more efficient, Thaler and Tucker say.

We urge the inquiry to consider the anti-competitive effects of huge conglomerate institutions and unequal access to data.

We also urge the inquiry to explore mechanisms for harnessing big data to increase demand driven competition.

[22] https://www.gov.uk/government/policies/providing-better-information-and-protection-for-consumers/supporting-pages/personal-data
[23] https://www.data.gov/consumer/page/smart-disclosure-policy
[24] Investor Advisory Committee recommendation available at http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-recommendation-data-tagging.pdf
[25] FN R Thaler and W Tucker Smarter Information, Smarter Consumer, Harvard Business Review Jan-Feb 2013 p 44

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7. Consumer protection regulation is to promote stability, enhance competition and protect consumers from market failure

As Wallis noted the general case for regulation is found in market failure. The committee made the case for specialist consumer protection regulation on two grounds – the complexity of products and the likelihood that consumers could misunderstand or be misled; and the high cost of resolving disputes. This led Wallis to recommend rules to protect consumers from unfair and fraudulent conduct; from inadequate disclosure of information on which investors can make informed choices; and to provide a pathway for more effective dispute resolution.

The 2008 Productivity Commission *Review of Australia's Consumer Protection Framework* said industry specific regulation "can be an effective means of providing consumer protection where the risk of consumer detriment is high and/or the quality of the product or service is difficult to establish prior to purchase."[26]

Both these conditions exist in financial services. Compulsory super has escalated the risks.

Compulsory super has brought all employees into financial markets –including many who would not otherwise participate and the risks of bad decisions can destroy lifetime savings and cost consumers their entire retirement income. This often occurs at a time of life where there is little chance of recovery. This is not a theoretical assertion but the last 15 years overflows with examples where people close to retirement or the in early years of retirement have lost their life's saving in the collapse of Commercial Nominees about fifteen years ago, through to Westpoint, Fincorp, Timbercorp (and a whole host of other corps) to Storm Financial and Trio more recently. Many of these cases involved business models driven by conflicts of interest, or fraud in the case of Trio.

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[26] Economic Roundup issue 1 2012
http://treasury.gov.au/PublicationsAndMedia/Publications/2012/Economic-Roundup-Issue-1/Report/Consumer-financial-protection

Key points page 81

The Productivity Commission made the point that "relatively few areas of significant consumer spending are not subject to industry specific consumer protection regulation" and said that **taking action after the event under the general law may not provide adequate protection where**:

1) **the risks and costs of detriment are relatively high, and if the detriment is "significant or irremediable"** or
2) **the suitability and quality of services is hard to judge before and even after purchase**. [27]

These characteristics exhibit at the extreme end of the spectrum in financial services. We have mentioned how detriment can result in a loss of life savings at a time of life where it is not possible to recover. In addition such is the complexity of many financial products that it is not possible for consumers to know what they have bought BEFORE or AFTER purchase.

The Productivity Commission notes the benefits of specific law is that it:

- facilitates consistency in approaches across consumers and markets
- allows regulators to deal with emerging problems, especially important in fast moving markets and
- imposes relatively few costs on the vast majority who do the right thing by consumers

The report notes that:

"the purchase of financial services can entail significant monetary commitments, sometimes over long periods of time. Hence the behavioural traits identified in (behavioural economics)[28] lead to imprudent decision, the consequences for consumers can be particularly costly. Moreover, purchasing decisions will often involve complex product comparisons, with consumers frequently relying on intermediaries to make these comparisons on their behalf. However, assessing the quality of such advice, even after the event, can be problematic. Accordingly, effective consumer protection measures are of particular import for these services."[29]

The Commission noted that in furthering the development of arrangements in financial services the law should ensure:

[27] P82
[28] Appendix B - explains behavioural economics and its relevance to consumer policy
[29] P99

- Comprehensive product coverage – ie no gaps for exploitation by unscrupulous providers;
- Appropriate balance between protection, empowerment and wide range of products and services and
- policy making and enforcement is responsive to a highly dynamic market that constantly offers new products[30]

We strongly support the broad thrust of consumer protection framework but argue for its evolution to deal with complexity, anti-competitive behaviour and other market failures (especially in parts 3, 4 and 7)

7.1 Consumer protection - regulatory arrangements

ASIC is the financial services consumer protection regulator and has developed and enhanced its role as the consumer protection and conduct regulator over the years since Wallis. The Super Centre, despite being a young organisation, through its Chair has worked closely with ASIC since it was created in the late 90s.

Overall we think ASIC is an effective regulator but its effectiveness has been constrained by the legal and policy framework in which it has operated.

It has been clear for some time that ASIC has been aware of, for example, the limitations of disclosure as a consumer protection tool (discussed in 4 above) and the limitations of the current licencing to raise the standards of financial advice (discussed in 9.2 and 10 below). Despite this ASIC has used a range of innovative policy tools within its remit to expose market problems and encourage industry to respond to those problems where it lacked the power to do so directly. For example its shadow shopping work in respect of financial advice has exposed the way in which commissions and vertical integration of the industry is impacting on quality of advice. However it was not within its ASIC remit to do more than require disclosure of commissions even though ASIC had evidence that disclosure had perverse effects ie it resulted in increased trust of the adviser

[30] P 99

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because only a good person could tell me something so bad.[31] Similarly ASIC is aware that vertical integration distorts advice towards products made by the organisation that owns the advice firm, reduces the quality of advice and the confidence consumers have in the advice industry and the financial system more broadly. This is a structural problem with the industry that is outside ASIC's remit.

In our view ASIC has sought to identify and focus on the big problems in the sector be it in the advice and investments or consumer credit space. Increasingly where it has identified an emerging problem it has sought to raise the issue publicly to prevent potential consumer losses. For example warning to the self-managed super sector about complex products[32] and real estate schemes[33]. However we are concerned that stronger tools may be necessary to deal with these issues such as those raised under part 5.2.

ASIC is an active player in the global regulatory environment and is very aware of international efforts to deal with increasing complexity and its impacts on competition, but the current framework in which it operates limits its capacity to keep pace with innovation in the industry.

ASIC needs a larger and more flexible toolkit to allow it to respond effectively to a fast moving and very innovative industry.

Consistent with points we make elsewhere:

- Behavioural economics needs to replace rational person in regulatory philosophy.
- ASIC needs powers to compel the provision of information in specified formats
- ASIC needs new tools to deal with complex products such as pre-market product approval process, standards setting for complex products, and obligations on product issuers for the manner in which their products are sold.

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[31] [31] The dirt on coming clean: The Perverse effects of Disclosing Conflicts of Interest http://www.cmu.edu/dietrich/sds/docs/loewenstein/dirtclean.pdf

[32] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Self-managed-superannuation-funds-and-complex-products--ASIC-update.pdf/$file/Self-managed-superannuation-funds-and-complex-products--ASIC-update.pdf

[33] http://www.asic.gov.au/asic/asic.nsf/byheadline/13-304MR+ASIC+warns+real+estate+industry+about+recommending+property+investment+through+SMSFs?openDocument

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7.1.1 Self-managed super

We note elsewhere in this submission about the rapid growth in self-managed super. Almost one third of super money is held in SMFS and the prevailing view is that the trend to SMSFs will continue for some time. The sheer size of the sector, the scale of growth, and the lack of understanding by some consumers who are setting up these funds (largely on advice) and the marketing of complex products to this sector together present as a considerable risk.

Once the preserve of sophisticated and wealthy consumers SMFS are now marketed more broadly to all consumers.[34] Drivers of this growth include loss of trust and confidence in financial services markets (detailed under 9 below) and a desire to minimise costs. Nonetheless most SMSF owners rely on a pool of advisers to assist them and many have entered the SMFS market on advice, but it is clear that not all owners understand the regulatory implications of such as choice as the PJC inquiry into the collapse of Trio exposed.[35]

Given the scale of the SMSF sector, the rapid growth and that these funds are becoming a vehicle of choice for the mass market there is a need to review the regulatory and policy settings for SMSFs.

7.2 Success of EDR

EDR schemes, both statutory and industry-based, have been operating for 20 years in Australia. In that time tens of thousands of consumers have had complaints dealt with and many have had their disputes satisfactorily resolved. Many of those consumers would not have had the capacity, financially or otherwise, to pursue their claims/complaints through the courts.

[34] ATO data shows that the median member balance in 2012 was below $100,000 with the median fund size around $200,000 http://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2011-2012/?page=16#SMSF_members_by_balance

[35] Para 7.58 PJC Trio Report

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Perhaps more importantly, the fact that these EDR schemes exist has, in our experience, had a profound impact on the behaviour of banks, insurance companies, credit providers and superannuation funds towards their clients.

Coupled with the increased emphasis on internal dispute complaints mechanisms, EDR schemes have provided a substantial incentive for financial services providers to communicate better with their customers and to explain and review their conduct and decision-making.

The use of procedural fairness letters, the discovery of relevant documents and the giving of reasons are, in our experience all linked to risk management practices employed by financial service providers to reduce the number of complaints before EDR schemes and to improve customer relations.

ASIC approves these schemes and ensures they comply with standards set out in RG 139. Most importantly ASIC requires periodic review of the schemes which has ensured ongoing improvement over time.

External dispute resolutions schemes have helped maintain confidence and strong relationships between consumers and financial services companies. Much of the success of EDR schemes can be attributed to ASIC oversight of the schemes.

Background

Industry-based EDR schemes arose in the financial services industry in the early 1990's.

The Banking Ombudsman, the General Insurance Enquiries and Complaints Service and the Life Insurance Complaints Service and a number of other smaller schemes grew out of a demand for consumers to have queries and complaints dealt with in an accessible manner in the banking, general insurance and life insurance industries.

Each scheme developed its own rules and procedures, including jurisdictional limits, time limits and powers of review of decisions. The schemes were designed to provide an alternative to dispute resolution via the civil courts which was perceived to be expensive, time consuming and not user-friendly.

They were designed to be quicker and cheaper than the courts with disputes to be resolved by conciliation or review determinations and 'on the papers' without resort to lengthy, stressful and costly oral hearings in an adversarial setting.

Decisions would usually be binding on financial services providers but consumers were free to take their disputes to the courts if not satisfied with an outcome. Financial services companies also have recourse to the courts on point of law arising from the contract which underpins their membership of an EDR scheme.

In conjunction with the introduction of compulsory employment superannuation in 1992, a statutory tribunal was established to deal with complaints against superannuation funds and associated third parties, including group insurers.

The Superannuation Complaints Tribunal (SCT) commenced operation under the *Superannuation (Resolution of Complaints) Act 1993*. The Act set out jurisdictional limits, time limits, procedures and powers of review of decisions by trustees and joined third parties.

The Act specified that the SCT was to resolve disputes by conciliation or review to be conducted in a manner that was 'fair, economical, informal and quick'-consistent with other EDR schemes. As an administrative tribunal, its decisions were subject to a right of appeal to the Federal Court on questions of law.

The Wallis committee reviewed the EDR schemes and considered two key issues:

1) Where arrangements should be rationalised and
2) Whether coverage should be broadened especially to cover small business.

Wallis recommended the creation of a national gateway for the then seven industry-based consumer dispute schemes and extending their coverage to small business. The report also noted that States and Territories should facilitate the creation a of nationally uniform dispute scheme for finance companies.

Those recommendations have eventuated. A gateway for the EDR schemes was established after a series of mergers, the number of industry-based schemes was reduced to two – with seven schemes merging to create the Financial Ombudsman Service (FOS) which has complete market coverage and a smaller newer Credit Ombudsman Service Ltd (COSL) which grew out of a fledgling mortgage brokers scheme. The SCT continued on a stand-alone basis, in part because of its unique status as a statutory scheme, although it did participate in the national gateway project.

Following Wallis the Howard government required all financial services licensees to be members of an ASIC-approved external dispute resolution scheme as a licence condition. Additionally before a consumer complaint could be brought to an external scheme the licensee was required to attempt resolution via an internal complaints process that met standards set out in ASIC regulatory guidance.

These processes, together with the Superannuation Complaints Tribunal, mean financial services companies and consumers have an effective alternative to the courts to resolve disputes.

However since the GFC complaints have ballooned in all schemes and delays are now a problem across the board. The SCT and FOS are actively working on resolving these matters. FOS was recently reviewed and the key recommendation concerned its timeframes and we have confidence that over time this issue will be resolved. The SCT[36] received additional funding in the 2013 Federal Budget to help clear its backlog of complaints and early signs are good with the average time for a complaint to be resolved by review determination dropping by 100 days.

FOS's caseload jumped dramatically at the time of its creation as a result of two key events.

1) New law that dramatically expanded FOS's remit. The introduction of national consumer credit law required all credit providers and authorised representatives to join an approved dispute scheme. This resulted in an influx of new members and complaints – within a short time of this new jurisdiction these new members accounted for 50% of FOS's case load
2) The GFC, which drove a large number of the credit complaints, especially those concerning hardship.

So at a time when FOS was bedding down a merger of five different schemes each with their own culture and unique way of operating its complaint load rapidly escalated. FOS nearly doubled in size in the three years from 2009 to 2012. Complaints growth outstripped FOS's capacity to service complaints and resulted in delays, well in excess of community expectations. FOS is actively engaged with the need to reduce timelines and we support the package of measures it recently announced to tackle the problem.

[36] The SCT is government funded whereas the EDR schemes being industry based are industry funded.

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Overall we think consumers have benefited enormously from these schemes. The recent review of FOS found that it meets the Federal benchmarks for dispute resolution schemes[37]. By contrast the COSL was found to be falling short of those benchmarks in particular in the key area of fairness. The review also noted practices that are less than consumer friendly[38].

We recognise that COSL, as the challenger scheme, has been an innovator in the area of financial hardship. However its lack of resources and its failure in some cases to treat consumers with appropriate fairness is of great concern to us. We think this behaviour has in part been driven through competitive pressures. COSL has also sought to position itself as a "low-cost competitor"[39] which the independent reviewers found had left the organisation without adequate funds.

We do not support a competitive framework for EDR schemes. Drivers of a competitive market such as choice, cost, service quality etc do not work when it comes to complaint schemes. Competitive forces only serve to drive down quality outcomes – as evidenced by the COSL review findings – and these result in inconsistent and unfair community outcomes. One reason market theory does not work for complaint schemes is that market choice can only be exercised by half the client base. Financial services companies are free to choose which scheme they belong to which compels their customers to use that scheme. The COSL review noted its status as a "low-cost competitor". We note the ongoing movement of licensees primarily from FOS to COSL of companies that appear to prefer schemes that are cheap and "less than consumer friendly". In response to member movement between the schemes , FOS and COSL have entered into an MOU to ensure a licensee cannot move between them without fulfilling any obligations to consumers arising from complaints on hand.

In a submission the Commonwealth Consumer Affairs Council on the review of the industry benchmarks for industry-based dispute resolution scheme ANZOA (the Australian and New Zealand Ombudsman Association noted[40]:

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37 Available at http://www.anzoa.com.au/National-Benchmarks-1997.pdf
38 See page 4 of report of 2012 Independent Review of the Credit Ombudsman Service available at http://www.cosl.com.au/cosl/assets/File/Independently%20Review%202012%20(The%20Navigator%20Group).pdf
39 Page 5 ibid
40 Available at http://ccaac.gov.au/files/2013/06/AustralianandNewZealandOmbudsmanAssociation.pdf

- ANZOA members recognise the value of competition for consumers in the provision of services. Indeed, in most of the industries in which ANZOA's members operate, there are markets for services that provide demonstrable cost, service and choice benefits for consumers. However, any possible benefit of competition in providing EDR services is outweighed by potential substantial detriment—to consumers, service providers and the community more broadly. ANZOA's considered view, after substantial consultation amongst ANZOA members, is that 'competition' in EDR is inconsistent with the spirit of the Benchmarks, and undermines principles of independence and effectiveness at the heart of the Benchmarks. Reasons for this include:
  - It is not in the interests of consumers/citizens or their advocates, as it may not be clear where to take complaints or which is the most appropriate service to deal with particular issues.
  - It is likely to add unnecessary and inefficient costs to Ombudsman services, e.g. inefficient duplication of infrastructure/resources/services/information systems, mechanisms to establish a 'common door' approach, and the need to provide information to consumers about different offices.
  - It may lead to manipulation of dispute resolution services, differing standards, and inconsistencies in decision making which could be adverse for consumers and participating organisations.
  - Poor performing organisations may choose to join an alternative EDR office that they believe is not as rigorous in its approach to complaints.
  - 'Competition' among EDR offices may encourage forum shopping by participating organisations, over which their customers (and consumers generally) have no control and no opportunity for any input.
  - An EDR office may focus more on participating organisations rather than on complainants or consumers in order to keep or grow its membership.
  - Where EDR offices are subject to regulatory approval and/or other regulatory mechanisms, regulators may need to set up separate reporting and communication systems for different offices, potentially about the same issues.
  - The value of the Ombudsman's office as a source of information and analysis to contribute to the ongoing improvement of an industry or service area will be diluted, to the detriment of consumers, service providers and the wider community.

For these reasons, ANZOA's stated public position is that there should be one external dispute resolution office only for any industry or service area. Other appropriate mechanisms can be used to provide a proxy for the benefits that can otherwise be derived from competing services. These mechanisms include appropriate governance arrangements, independent reviews and public reporting, matters that the *Benchmarks Document* already provides for.

This view was supported by a number of other submissions to the review including from CHOICE, Consumer Action Law Centre, and Consumer Credit Legal Service NSW among others[41].

While we think the EDR schemes have been a great success story post Wallis there is scope for further rationalisation of the sector.

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[41] All submissions available at http://ccaac.gov.au/2013/04/24/review-of-the-benchmarks-for-industry-based-customer-dispute-resolution-schem

A single scheme with complete market coverage would have the advantage of profile, efficiencies of scale, and consistency of outcomes for all parties. ASIC requires an independent review of approved EDR schemes every three to five years and the evidence is these reviews have provided an important accountability mechanism and provided ongoing pressure for reform.

External dispute resolutions schemes have helped maintain confidence and strong relationships between consumers and financial services companies.

However market forces for complaints schemes only serves to drive down quality of services and increases consumer detriment.

We support a merger of the Financial Ombudsman Service with the Credit Ombudsman Service to deliver. This will ensure nationally consistent outcomes for consumers and industry alike; will deliver efficiencies based on scale and will increase consumer access through a single national brand.

7.3 Financial literacy

Financial literacy is a prong of consumer protection regulation yet the ABS has found that the literacy and numeracy skills of Australians fall well short of the standard required for understanding financial products[42] .

ASIC has also documented the limitations of financial literacy[43]. ASIC says financial literacy is a "wicked problem" and "beyond the capacity of another one organisation to understand and respond

[42] See ABS Adult Literacy and Life Skills Survey Summary results available at http://www.abs.gov.au/AUSSTATS/abs@.nsf/Previousproducts/4228.0Main%20Features22006%20(Reissue)?opendocument&tabname=Summary&prodno=4228.0&issue=2006%20(Reissue)&num=&view=

[43] Financial Literacy and Behavioural Change Report 230 March 2011 http://www.financialliteracy.gov.au/media/218309/financial-literacy-and-behavioural-change.pdf

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to”.[44] ASIC’s Money Smart is an important initiative, as are a range of industry-based initiatives such as AFSA’s SuperGuru.

However financial literacy on its own cannot be relied on, on its own, as a consumer protection tool. Changes in consumer behaviour from financial literacy programs take place over decades, which is too late for many consumers. To bring about change top down and bottom up approaches are required, with constant innovation to meet consumers changing needs and preferences.

We think there is an urgent need to respond to the rise of social media and increased consumer trust in peer platforms. Wicked problems require a range of responses and the rise of social media suggests a new approach to literacy programs may be necessary. There is a clear opportunity for the development of community-run social media platforms to assist consumers via peer-to-peer discussion meditated by an expert community-based peer. For example the consumer organisation CHOICE is perceived by its members as an expert consumer peer – an organisation who is their corner and their corner alone. By contrast government and industry are not viewed as peers, nor are they seen as having consumer’s sole interests at heart.

We think superannuation consumers would benefit from a community run social media platform on superannuation to engage, educate and empower consumers to complement existing government and industry financial literacy programs.

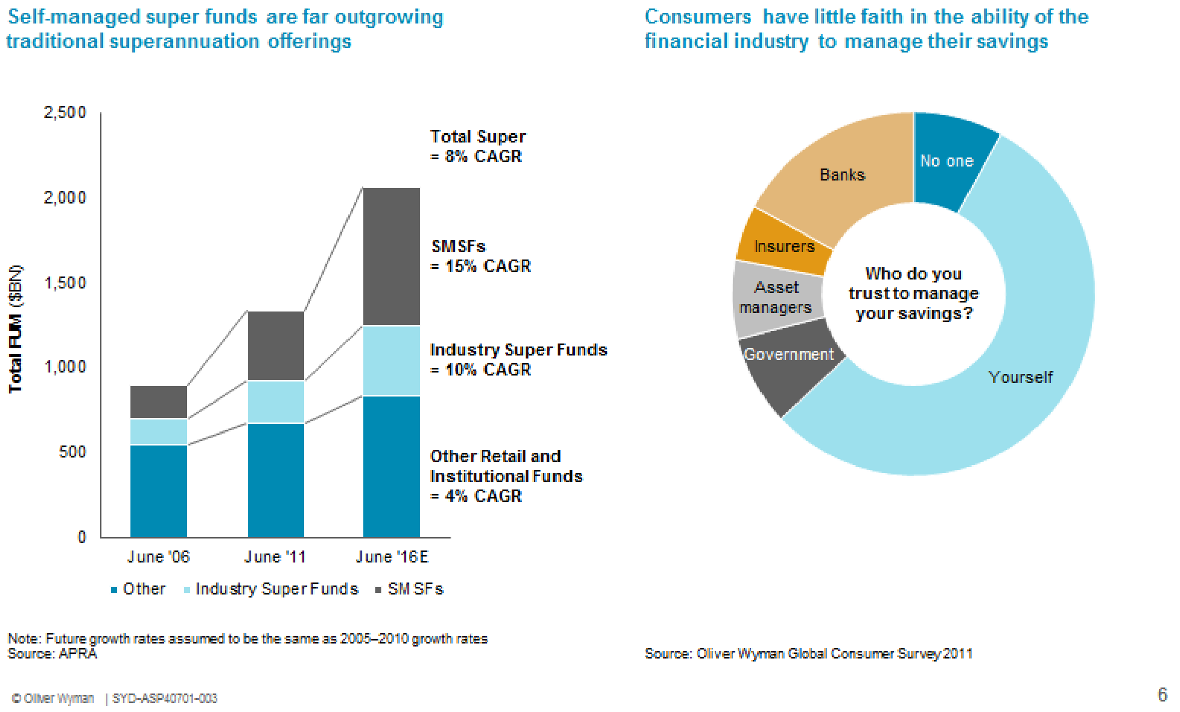
This is a key part of our proposal for a Superannuation Consumers Centre detailed in section 3.4 below. 60% of the Centre’s focus would be on policy input to government and industry process. 40% of our focus would be on building a social media platform as a vehicle for peer-to-peer education and assistance on superannuation. Further details are on page 20 – 23 of the business case Appendix 1 and pages 8 – 12 of the business plan at the back of Appendix 1 .

8. Consumers appear to be losing trust in the superannuation system

Consumer confidence in the ability of the financial industry to manage their savings is lower than it should be. Far too many prefer to manage their savings themselves than allowing financial

[44] Ibid page 53

institutions to assist them. This is evidenced in Australia through the rapid rise of funds in self-managed super funds –with 30% of super assets held in SMSFS at nearly 532 billion[45].



We see four key drivers of loss of trust.

[45] APRA statistics, December 2013 available at http://www.apra.gov.au/Super/Publications/Documents/December%202013%20Quarterly%20Superannuation%20Performance.pdf

1 Disappointing returns

- Cyclical issue of current market performance
- Structural problem of industry inability to fulfil promise of above benchmark returns (in aggregate)

2 Conflicts of interest

- Partially addressed by FOFA reforms but legacy mistrust remains
- Scams continue to exist as extreme forms of conflict of interest

3 Costs

- Partially addressed by MySuper/StrongerSuper reforms
- Costs of advice, management, administration remain high compared to customer perceptions of value

4 Policy volatility

- Regular changes to tax treatment of superannuation have impacted consumer confidence in the long-term stability of the framework

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But erosion of trust matters for all stakeholders.

Impact of lack of consumer trust in superannuation on different stakeholder groups

Consumers

- Smaller retirement balances due to
  - Less discretionary savings
  - Less optimisation of costs and taxes
  - Worse investment outcomes from lack of professional advice and management
- Greater vulnerability to scams and fringe operators
- Time costs of independently managing affairs

Government

- Greater retirement funding liability due to smaller personal balances
- Scams undermine public confidence in the Government's competence to regulate
- Smaller financial services taxation revenue base
- Reputational impact on Australia's positioning as a financial centre

Industry

- Lower flows into the system and therefore lower funds under management
- Shift of asset allocations to lower margin (e.g. passive) or no margin (e.g. SMSF) products
- Missed opportunities to deepen customer relationships – e.g. with post-retirement products
- Broader damage to industry reputation and standing

The principal theme of this submission is that a suite of measures are needed to restore confidence in the system.

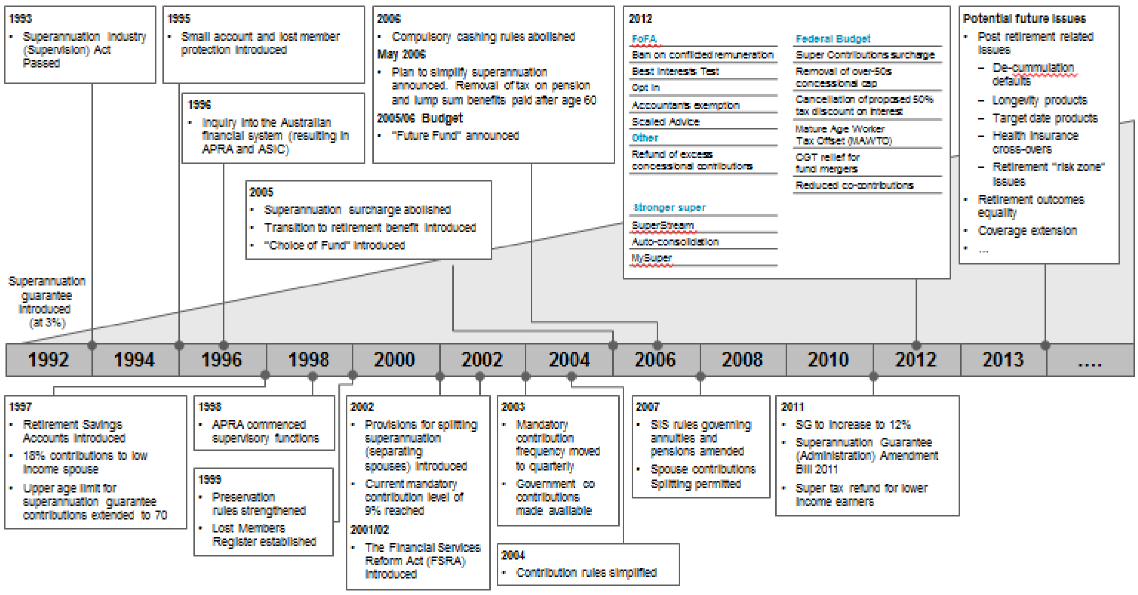
First and foremost consumers need someone in their corner.

We see three key interventions that would help restore trust and improve outcomes.

Intervention	What is it?	How will it help?
1 Advocacy	• Influencing Government policy and industry practice in the interests of consumers • Targeted research and analysis • Providing a consumer perspective on emerging super issues	• Ensuring more balanced and consumer oriented outcomes on matters of importance to them • Second order benefit from awareness raising/education
2 Assistance	• Triage and referral services for consumers experiencing problems with their super • Gathering and disseminating intelligence on risks and issues	• Helping consumers navigate the complexity of the system • Helping regulators enforce and improve the rules by supplementing their intelligence gathering capabilities
3 Education	• Provision of information and awareness raising • Leveraging social media to facilitate peer-to-peer education	• Influencing consumers to act in their own interests in managing their super • Helping consumers make better decisions

Advocacy | Assistance | Education

Consumers are facing constant change and an increasingly overwhelming range of policy issues affecting their superannuation…



…and the system is unlikely to be "settled" for some time to come

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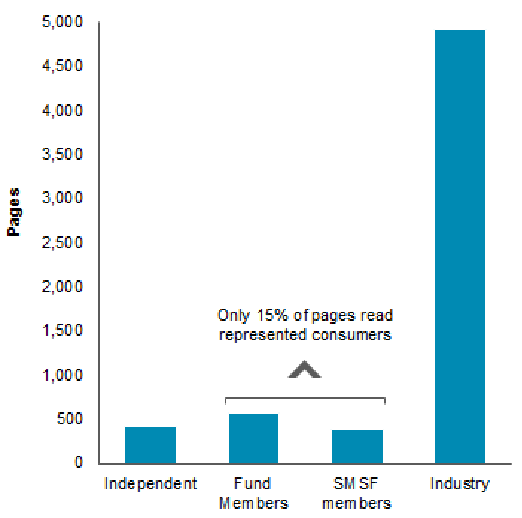
Advocacy | Assistance | Education

…more advocacy would help represent consumer interests in policy debates, influence industry practice, and raise consumer awareness

Consumer perspectives are under-represented in policy debates
Submission pages read by Cooper Review by source



Source: Cooper Review

Policy advocacy

- Consumers are under-represented in the debate on superannuation policy due to the absence of an entity to research, analyse data, formulate policy and communicate views on their behalf
- e.g. Cooper Review, Stronger Super, etc.

Practice advocacy

- Industry is often open to reflecting consumer perspectives in practice guides such as codes of conduct, but lacks a body to engage with to better understand these
- e.g. advisor codes of conduct for FoFA compliance

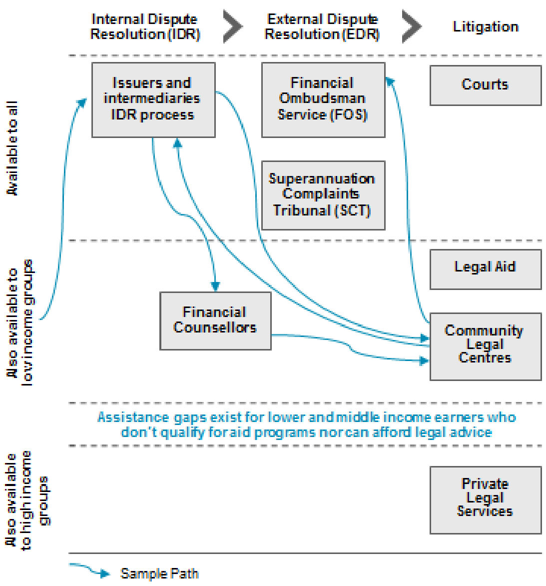
Awareness raising

- The publicity associated with policy and practice advocacy can also have a considerable positive impact on consumer awareness of the focus issues
- e.g. the FoFA debate and advisor conflicts of interest

Advocacy | Assistance | Education

The complexity of many of the processes surrounding superannuation creates a need for assistance with triage and referral (which can also support intelligence gathering)

Example process: Managing a dispute with a provider is complex and support is not available to all



Perspectives

- Consumers are often ill-equipped to make key decisions around super, e.g.
  - Selecting a quality financial advisor
  - Understanding options for managing a dispute with a provider
- Consumers would benefit from an assistance service covering
  - Triage of needs
  - Provision of basic legal advice and referrals for more complex needs
  - Online tools supporting simple processes like account consolidation
  - Support assessing the quality of financial advice

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Advocacy | **Assistance** | Education

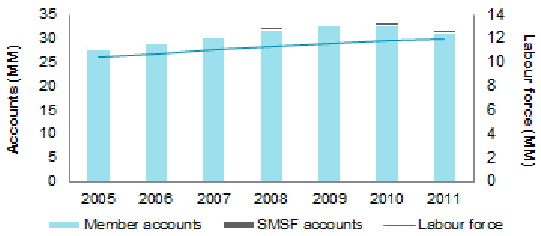
Consumers as a group would also benefit from assistance aimed at gathering and disseminating intelligence on issues and risks in the system

- Consumers would benefit from more targeted actions to protect their interests by both regulators and industry
- Such actions would be supported by more intensive and systematic intelligence gathering and dissemination
- A key area of potential is the capture of front-line data about consumer problems with super and providing reports and analysis to providers in relation to service issues and regulators in relation to policy and conduct issues
- A systematic approach to identification of "super complaints", systemic issues and test cases that deserve scrutiny and may have broader policy ramifications would be beneficial

Advocacy | Assistance | **Education**

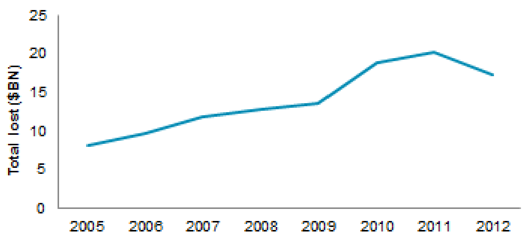
More effective education is required to encourage consumers to act in their own best interests in the management of their superannuation

Individuals are not consolidating to reduce their fees paid – there are 3x as many accounts as working Australians[1]



- Individuals are not acting to optimise their benefits
- On average working Australians have more than three accounts
- Fees (and in some cases unnecessary insurance) are reducing balances
- SMSFs represent a material proportion of balances but immaterial percentage of accounts
- Consolidation is often considered complex or is outside the scope of attention of many Australians

Consumers are losing invested funds – the amount of lost superannuation has grown by $3.6 MM per day since 2005[2]



- Australians are not acting to ensure super remains connected to them and are losing money as a result
- Lost super balances have increased by $9.2 BN since 2005 to reach 17.4 BN
- The issue also creates additional administrative costs and complications for the industry
- Lost super balances now represents approximately $1,690 for every working Australian

1. APRA Annual Superannuation Bulletin June 2011
2. ATO
3. Treasury

Advocacy | Assistance | Education

There is a lot of education provided to consumers – but no dynamic interactive consumer to consumer engagement

The Government and industry have invested in good education initiatives

MONEYSMART

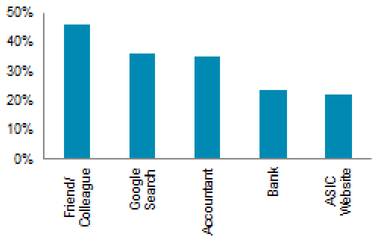
Davidson Institute – Australia's First School of Money.

Commonwealth Bank Foundation

Australian Government – Financial Literacy Foundation

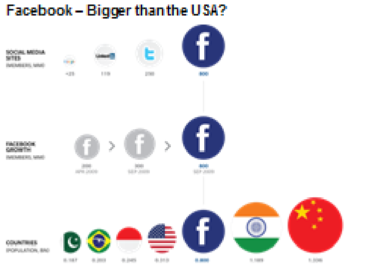
…but these are broadcast in nature and do not tap the power of peer-to-peer communication

Consumer have long turned to friend first, to find a planner (sources of recommendation)



…in age of social media, consumers increasingly value other consumer to consumer content

Facebook – Bigger than the USA?



Source: CIA Factbook, http://news.yahoo.com/number-active-users-facebook-over-years-214600186--finance.html

Consumer-to-consumer education

- Superannuation education could be enhanced with the addition of an on-line peer-to-peer hub that allows sharing of experiences on
  - Investment products
  - Providers
  - Advisors
  - Savings and investments strategies
- Based on a wide range of experience from other industries, such a tool could achieve significantly more impact than traditional means of education (albeit with risks of mis-information)

Australia has a strong policy and regulatory framework for super, but none of the relevant agencies are positioned to execute these interventions

Assessment of capacity of Commonwealth agencies for superannuation consumer oriented interventions

Agency	Super role	Advocacy	Assistance	Education
ASIC	• Conduct and disclosure regulator • Aims to ensure consumers dealt with in accordance with the law • Financial literacy responsibility	• Policy advocacy most often used when limits of regulatory tools have been established • Open to consumer inputs, but no mandate to develop positions on behalf of consumers	• Focused on breaches of law, large class recoveries, little capacity to help with individual problems • Intelligence skewed to complaints (in non super areas community based advocacy groups are major source of intelligence)	• MoneySmart is an excellent information and education tool but a regulator is not an appropriate sponsor of consumer to consumer education
Australian Government – The Treasury	• Policy advice to Government, based on objective and thorough analysis of options	• Lacks resources to generate independent consumer focused research • Lacks an expert consumer group to engage with • Limited capacity to research and develop positions on behalf of consumers outside of major reforms	• No direct assistance capability	• No education responsibility
APRA	• Prudential regulator • National statistics agency • Implements government policy	• No remit to advocate for consumers	• No direct assistance remit or capability • Some access to relevant data but limited capacity to use data on behalf of consumers	• No education responsibility
Australian Taxation Office	• Focused on SG and SMSF compliance, some tools to help consumers, significant role in implementation of Stronger Super	• Conducts some research, no remit to develop positions for consumers	• Helps individuals with SG • Some access to relevant data but limited capacity to use on behalf of consumers	• Website has good information and some good tools but limited in accessibility and consumer appeal

Suitability ● High ○ Low

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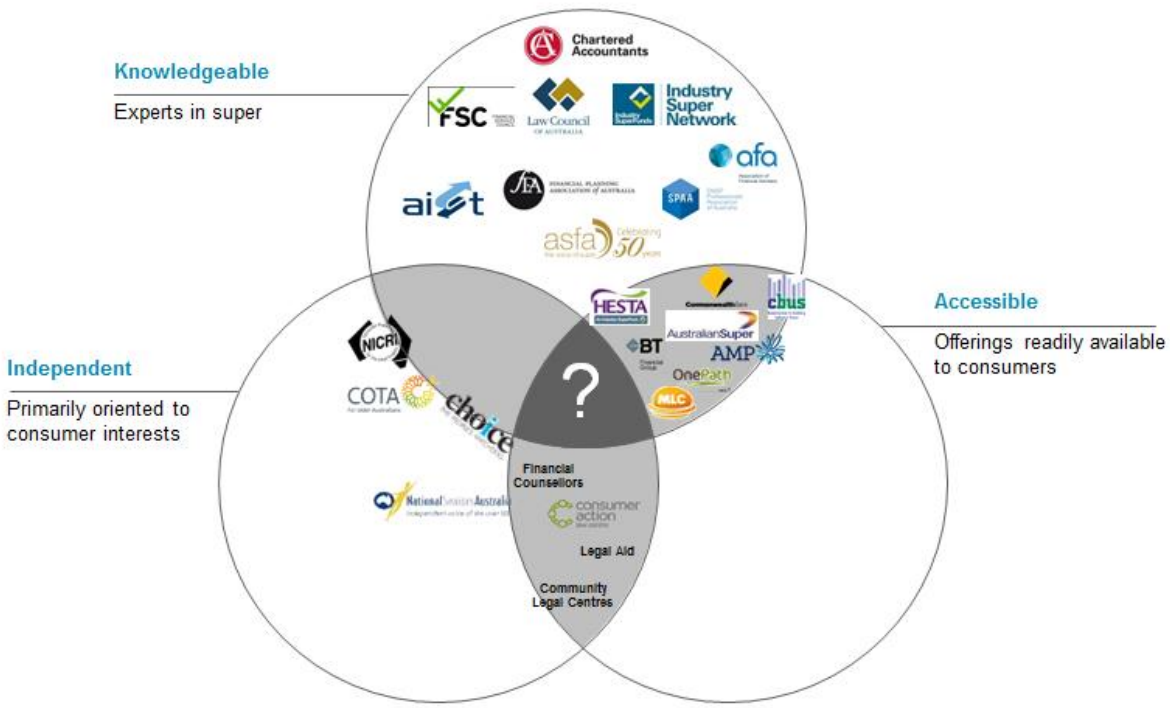
…nor do existing private sector or community bodies have the right combination of knowledge, independence, and accessibility to fill these gaps



We recommend the establishment of a dedicated, expert Centre for Superannuation Consumers as a positive contribution to restoring consumer trust.

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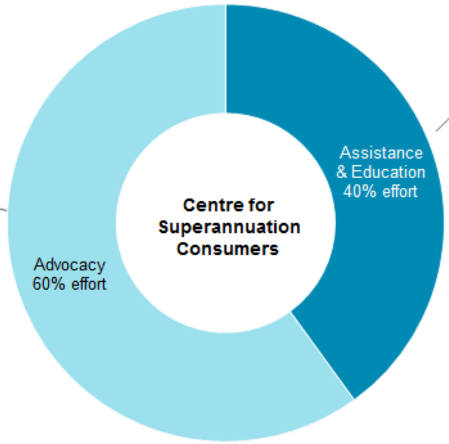
Purpose – To improve the operation of the superannuation and retirement income system so that it delivers the best possible retirement income for Australian consumers

Mission

- To advocate for consumers' interest in the superannuation system
- To research and analyse consumer issues in the superannuation system
- To identify and act on systemic issues



Mission

- To provide direct assistance to consumers to help them navigate the super system
- To gather and disseminate intelligence
- To engage, empower and educate consumers to act in their own interests to achieve better outcomes

The capabilities of the Centre will sit in the currently vacant intersection of knowledge, independence, and access

60% of the Centre's efforts will focus on advocating consumer interests in policy-making and industry practice

Advocate for consumers' interest in the superannuation system

Focus areas - Advocacy

Research and analyse consumer issues in the superannuation system

- Undertake research, analysis and policy development on consumer issues in superannuation
- Provide on-going advice on industry development from a consumer perspective to Government
- Build networks amongst consumer groups, academics, government and industry, and facilitate consumer representation on government and industry committees, Boards etc.
- Priority issues will likely include
  - Bedding down Stronger Super and FoFA reforms
  - The "retirement risk zone"
  - Architecture of retirement phase including draw-down defaults
  - Consumer interests in self-managed super
  - Improving outcomes for the most vulnerable
  - Cost and value issues

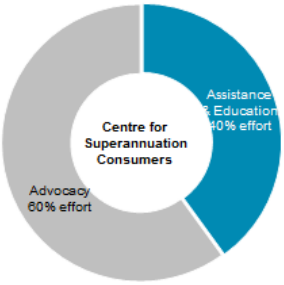
Increase consumer influence on policy makers, regulators and industry

- Be a strong independent voice for consumers in the development of superannuation policy, regulatory reform and improved industry practices

Facilitate better consumer involvement

- Provide a means by which consumers can enter into effective dialogue with government and industry about superannuation issues, in particular about regulatory, co-regulatory and self regulatory initiatives

40% of the Centre's efforts will be focused on assisting, engaging and empowering consumers to act in their own interests – these activities will be delivered through a social media platform dedicated to superannuation



Provide direct assistance to consumers to help them navigate the super system

Focus areas – Assistance

Triage and referral service

- Largely provided through on-line tools, fact sheets, interns and volunteers

Data capture

- Provision of objective advice to government, regulators and industry about issues effecting super members and consumers, including emerging systemic issues

Delivery

Via social media platform (designed to facilitate two-way communication with consumers and provide a pathway to additional funding from consumer memberships)

Limitations

- No advice to be provided which could require licencing under the Corporations Act
- The Centre will keep ASIC informed of its assistance activities

40% of the Centre's efforts will be focused on assisting, engaging and empowering consumers to act in their own interests – these activities will be delivered through a social media platform dedicated to superannuation

To engage, empower and educate consumers to act in their own interests to achieve better outcomes

Focus areas – Education

Engage and educate consumers through a dynamic interactive online hub for consumers by consumers

- Find innovative ways to connect consumers to existing superannuation tools and content
- Foster development of new tools and content where gaps exist
- Creatively use digital tools and social media to connect consumers to the Centre and each other through a vibrant online community

Awareness raising on key issues

- Explore and report on new products or new concepts as they come to market
- Warnings on dodgy and illegal schemes
- Use APRA, ASIC, FOS,SCT data to provide accessible information to consumers
- Analysis, interpretation and clear presentation of complex information for consumers

Delivery

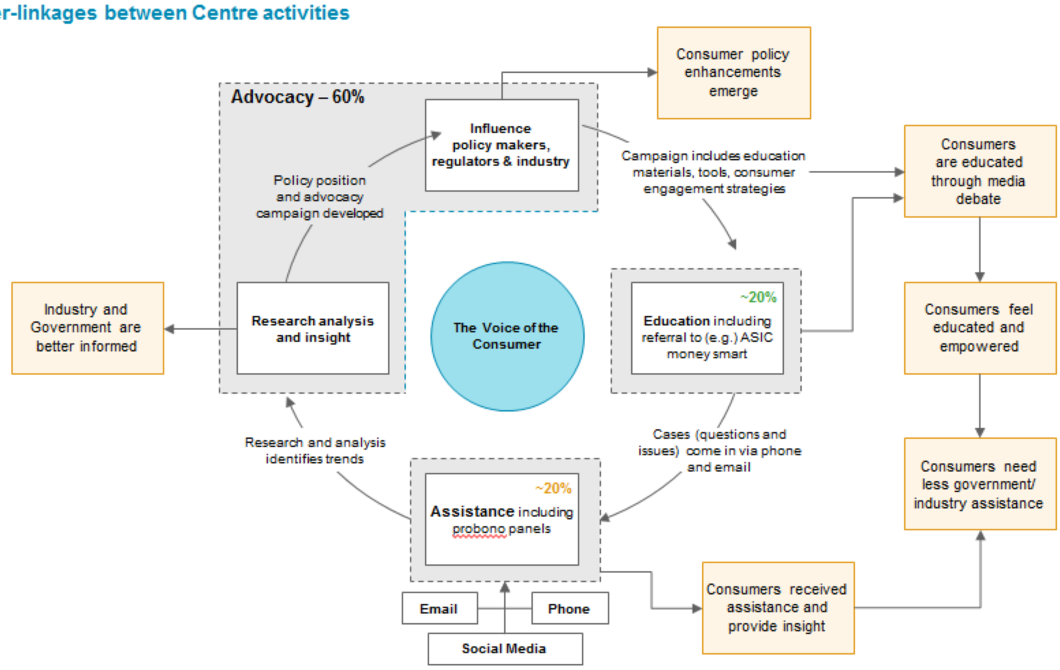
- Via social media platform (designed to facilitate two-way communication with consumers and provide a pathway to additional funding from consumer memberships)

Limitations

- No advice to be provided which could require licencing under the Corporations Act
- The Centre will keep ASIC informed of its educational activities

Each of the Centre's activities will be mutually reinforcing

Inter-linkages between Centre activities



The three functions of the Centre will each provide direct benefits to all stakeholder groups

Key benefits to stakeholder groups by Centre function

Consumers

Advocacy

- Increased chance of policy changes addressing consumer interests
- More consumer oriented industry practice
- Increased awareness of key issues

Assistance

- Increased ease navigating the system (especially for lower-middle income earners)

Education

- Higher probability of taking action and making right choices to improve super outcomes

Government

Advocacy

- Provision on-going consumer oriented advice on super issues as the system evolves
- Central point of contact available for exploring policy options from a consumer perspective

Assistance

- Improved intelligence for regulatory action
- Provision of super complaints, systemic issues or test cases for enforcement, law or policy action

Education

- Impact of existing financial literacy efforts enhanced and magnified

Industry

Advocacy

- Central point of contact available for on going dialogue and dialogue on specific issues e.g. new products, codes of conduct
- Opportunity for dialogue on alternates to regulation as a way of addressing consumer concerns

Assistance

- Opportunity for early warning of emerging conduct issues prior to regulator intervention
- Reduced consumer confusion and frustration in dispute scenarios
- Consolidated customer feedback

Education

- Greater voluntary savings flows
- Reduced wasted administration costs

Potential benefits need only be a tiny fraction of what could be achieved to justify investment in the Centre

Potential benefits upper-bound estimation by stakeholder group

Consumer

- 10% of lost super re-united with its owner
  - $1.5 BN in additional available retirement funding
- If all working Australians went from three to two accounts (assuming $5 per month fee)
  - ~$700 MM per year of duplicate fees saved
- 10% less consumers affected by Storm Financial
  - $300 MM in increased retirement funds
- A 0.1% increase in investment returns
  - $1.3 BN in increased retirement savings

Government

- If on average half the population could self fund for one more year
  - $2.1 BN in costs avoided per year
- If one Storm, Trio, or Westpoint style collapse could be avoided Government could save ~$5–20 MM in direct costs

Industry

- If 2.5% more Australians sought financial advice (assuming average $1.5 K annual fee)
  - $500 MM additional planning revenue
- Avoiding levy impositions from future "Trio-like" cases
  - $55 MM levy avoided
- If 2% more working Australians make a $5,000 voluntary contribution
  - $1 BN in additional inflows
- If 20% less mail was incorrectly addressed (due to lost accounts)
  - $6 MM in costs avoided

We believe that the right time to establish such a Centre is now due to the current characteristics of Australia's superannuation system

Characteristics of today's superannuation system

Policy change

- Significant level of policy change including
  - Stronger Super
  - FoFA
  - 9–12% increase in compulsory contributions
- Policy change agenda likely to continue evolving rapidly for years to come
- Government efforts to engage and protect consumers – opportunities for greater consumer involvement
- Industry initiatives require consumer engagement, e.g.
  - Codes of practice
  - Professional standards

System maturity

- With 20 years of SG, the system is reaching maturity and the stakes for consumers and government are high
  - Large individual balances to protect and grow for many consumers
  - Large potential contribution to reducing the Government's funding burden
- Significant numbers of people now reaching the drawdown phase with new needs, creating new policy issues
- Major revenue pool for the financial services sector

Consumer characteristics

- Early indicators of some loss of faith in the system
  - Less voluntary inflows
  - Explosive growth of SMSFs
- People are living longer and therefore require superannuation balances and longer draw-down periods
- The current retiring generation is the first to include a significant number of self-funded individuals

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8.1 Options to kick start a Superannuation Consumers Centre

The full business case for establishment of Superannuation Consumers Centre is at Appendix One. The business case also details the extent of support for the Centre. There are a number of options for funding the Centre.

1) Government to provide special listing in the *Income Tax Act* to allow the Centre to receive **Deductible Gift Recipient status.** This would allow the Centre to obtain funding from those in the community who support its goals.
2) Government to provide **seed funding** to enable the Centre to **construct a social media platform on superannuation that provides an avenue for ongoing consumer funding**.
3) **Use the superannuation industry levy** to fund the Centre.
4) **Encourage the superannuation industry to provide seed funding for the Centre with a matching contribution from the Government.**

9. Superannuation forces us into investment markets at a vulnerable time in our lives.

We strongly support the objectives of the compulsory super system. It was built to ensure a comfortable and secure retirement for current and future generations. It is a robust system on a global scale (see Melbourne Mercer Global Pension Index October 2013). However one consequence of the system is that it has **forced all employees into investment markets**, including **many who would not have chosen to participate by preference, or because they lack the financial resources and/or skills and confidence to do so**.

Compulsory super also **creates huge demand for financial advice** because of the **complexity of the system** but also because of **lack of an agreed pathway for consumers in the retirement phase**. Consumers come out of 20, 30 or 40 years of accumulation with a lump sum and are effectively left to their own devices. Policy settings for the super system are well developed in the accumulation phase and importantly we now have agreed standards for the default option – My Super - but **there**

is no agreed framework in the retirement phase. The lack of an agreed framework for the retirement phase means consumers bear excessive risks, risks which they are not equipped to cope with, and with no amount of information provision can overcome.

One consequence of the current SG policy settings is that for many people super will be the largest amount of money they have had over the course of their lives and these **investment responsibilities are foisted on them at a very vulnerable time in their lives**. It doesn't matter who you are or what you have done with your life – if the first time you have significant funds to invest is at age 55 – 70 you are by definition a vulnerable consumer.

Up to the point of retirement the much of the super system is founded on a strong understanding of consumer behaviour. The accumulation phase is built on compulsion, with a default option with recently agreed standards, life insurance embedded in super is on an opt-out basis, commissions are banned for sales of super products, but once consumers arrive at the retirement phase they are effectively handed a lump sum, and faced with a vast array of complex products and choices and given a good luck card.

Consumers are effectively forced to obtain financial advice to cut through this complexity. Yet a key reason consumers are losing trust in the system is because structural conflicts in the advice industry have seen consumers lose some or all of their retirement savings.

This raises a number of related issues which need to be dealt with in turn.

1) The policy vacuum in the retirement phase of super
2) Advice risk issues and the need to develop an independent advice profession

9.1 Policy vacuum in the retirement phase

The accumulation phase of super has been subject to much debate and policy settings have recently been agreed. Default funds have been a feature of the system from its inception and through My Super we now have agreed standards for default options.

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But a policy and architecture vacuum exists in the retirement phase of super and consumers at their most vulnerable, at the point when they have no capacity to recover from poor choices are subject to a total choice regime.

The super system is built on insights from behavioural economics – in its use of compulsion, defaults, opt-out settings and commissions ban – but at the critical juncture – at arguably the most challenging time consumers are left to their own devices.

Not all Australians have the skill or desire to spend their retirement years managing a superannuation portfolio. More than ever the system should not force consumers to obtain financial advice given the well documented shortcomings of the industry. The accumulation phase of super is has options for the engaged and disengaged. Similarly **the retirement phase should have a default that ensures the system works for those who don't wish to spend their retirement mired in the intricacies of financial markets.**

We are not saying the default option should be the mandatory choice, rather it must exist for consumers who are unable or do not wish to deal with the complexities.

A default option could sit inside a policy framework that may for example:

- allow retires complete discretion in spending the first x dollars of their super accumulation (this could be as high as $300,000)
- require from x to y dollars to be taken in some kind of income stream product and
- allow complete freedom above y dollars.

The policy framework could also usefully address other issues such as the relationship between retirement age and rates of longevity, need to create employment opportunities for older Australians etc

We support the development of a policy framework for the retirement phase of super which must include a default option for those who need and or prefer it.

9.2 Advice risk

To mitigate risk and deal with complexity, consumers need advice intermediaries but the industry structure means consumers cannot and do not have confidence in advice

Consumers need financial intermediaries to address the huge information asymmetry in financial markets. Asymmetries arise because consumers lack knowledge and skills to deal with the complexities of the industry.

ASIC and FPA surveys note less than 20% of Australians obtain financial advice.

In our experience there are two key groups who avoid advice:

1) High net worth clients – particularly professional groups - who have stayed away from the industry, distrustful of the conflicted nature of advice and standards that have jarred against their own professional obligations; and
2) middle income Australians who need specific advice not expensive comprehensive advice who are distrustful of the conflicts and lack of transparency in the industry.

The risks that attach to the super system are well articulated in the Mercer Global Pension Index[46] but one risk that the Mercer Index does not discuss is what we would call **advice risk**.

The last decade has brought advice risk into sharp focus, where the number disasters specifically involving the inappropriate investment advice of retirement funds that have seen retirees lose most or all of their retirement savings.[47] These have had catastrophic effects on some individuals but

[46] P20 – 21 Investment risk, sequencing risk, longevity risk, inflation risk, expenditure risk, timing/interest rate risk, counterparty and liquidity risk (in terms of specific products) and legislative risk

[47] See 2009 PJC report into financial products and services in Australia and 2012 PJC Inquiry into the collapse of Trio Capital

more importantly they have combined with other factors and significantly eroded trust and confidence in our financial system and particularly the super system[48].

While the Gillard Government responded to many of these issues through the Future of Financial Advice package of reforms, at the time of writing the Abbott Government has committed to winding those reforms. Our specific concerns with the wind back are:

- **They will introduce new drivers in the industry** that will **reinvigorate what was a dying sales culture in the industry. The will distort the market towards general advice and execution only;**
- **They will mean average Australians will continue to pay commissions on financial products**, **which will be sold to them via general advice rather than personal advice**.
- **Some consumers will be locked into commission paying products, possibly until they die,** and a **significant legacy product problem will be created.**
- Rather than reducing conflicted remuneration and increasing access to personal advice in the general community we think these proposals will mean **conflict free personal advice will become available only to the very wealthy**.
- Allowing advisers to contract out of the best interests duty will **make it very hard for the Financial Ombudsman and ASIC to take action** in the face of inappropriate and poor advice.

The FoFA reforms sought to put the financial advice industry on a professional footing by getting rid of conflicted remuneration. At their heart they were about creating an advice profession to cater for the massive advice needs compulsory super creates. **Given that the Government compels Australians to enter the superannuation system which requires consumers to obtain financial advice it is incumbent on it to ensure that a structurally independent advice profession exists**.

We support structural separation of financial advisers from product makers.

9.3 Superannuation is sold as "wealth creation" rather than retirement income

In the time since Wallis the financial services industry has rightly embraced the superannuation system but it has dramatically altered the principal narrative of retirement incomes policy.

[48] See consumers losing trust below

The narrative of superannuation conducted by all parts of the industry is no longer one of retirement income. It has become one of wealth creation. In fact superannuation has driven a dramatic expansion of the financial services sector and given birth to what is now known as the wealth management industry. The interplay of consumer's needs (ie to accumulate a pool of funds to generate an income stream in retirement) and the industry's narrative around super ie wealth management encourages consumers to think that complex financial products that they don't understand can magically deliver better outcomes for them.

The Storm Financial business model elevated the concept of wealth creation to almost cult status. There was a lengthy processes by which clients were inducted into the cult, before they were progressively urged to" take the next step". According to Paul Barry[49] in this period there was a "glamorous gala for Storm investors in the fifteenth-century Odescalchi Castel in Italy, where celebrities Tom Cruise and Katie Holmess were married. " It was all part of the wealth cult – creating the illusion that wealth can somehow be magically created.

Surveys find few consumers are actively engaged with super until their early 50s. Around this time they can see retirement on the horizon, their children have grown and their mortgage is nearly paid off. For the first time they have available income to put into superannuation but at the same time they feel time is running out for them to save to fund the sort of retirement they wish.

This is where the domination wealth management narrative of the industry collides with consumers hopes and dreams and increases consumers vulnerability to sales pitches about complex products that they cannot understand nor do not meet their needs. Consumers buy the sales narrative because the bigger narrative of wealth creation suggestions something magical –incredibly technical and complex - that consumers couldn't expect to understand. This narrative also increases consumers' vulnerability to claims that are too good to be true. The wealth creation narrative almost implies that financial products can achieve the impossible.

We think there is a need to reframe the narrative of superannuation away from wealth management and back towards retirement income, however unglamorous the latter is compared to the former.

[49] http://www.themonthly.com.au/issue/2011/february/1299634145/paul-barry/eye-storm

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1. Towards an advice profession

The integrity of the super system depends on the emergence of a high quality advice profession.

What might a professional look like?

A **highly educated** workforce– both at entry level and higher learning accreditation programs alongside life-long education through continuing professional development

Strategy and analytical advice would be the primary offering with product recommendations a secondary consideration and implementation a distant third – strategy and analysis will be what consumers will primarily pay for.

The **client's interests will be front and centre** –conflicts of interests would disappear including asset based charging, there would be **structural separation between product and advice**.

Fees will be completely transparent – not concealed by percentages or charges that change with market movements. They will be appropriate to the level of training, skill and expertise of the adviser and the complexity of the task, and **formal consent will be obtained**. Not two yearly under opt-in rules but annually if there is an ongoing advice relationship.

The quality of any profession depends on its **professional associations**. These would lead the profession in the attainment of high standards, actively helping members reach these standards and better manage the rump of the industry.

More must be done to facilitate the development of an independent trusted advice profession.

11.1 Transition to professionalism

The foundations of a profession - a concept built up over centuries - generally encompasses three core elements:

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1. High levels of technical proficiency; and

2. High standards of ethics - stemming from higher duties to clients – usually a fiduciary duty – which arises when one party is highly dependent on the other, a fiduciary duty requires to advice giver to act in the client's best interest

3. Client care from beginning to end of relationship ie fulfilment of promises

11.2 Technical proficiency derived from significant body of learning

Professionals earn their status through a recognised standard of education and learning. This starts with entry level standards, followed by accreditation for higher learning, followed by lifelong learning.

In terms of the current framework the bar is too low at all steps of the way – both at entry level training and ongoing requirements – but critically it doesn't **consistently** deliver good outcomes – outcomes depend on the licensee and/or training provider.

What we have is extreme diversity in practices – people entering the industry with quality finance, economics, business, accounting and/or auctorial university degrees, followed by high quality training provided by some licensees and short courses offered by RTOs with no prior learning at the other end. As some say five months to become a financial planner five years to be a hairdresser.

Five months is an improvement on the recent past when entry to the industry to the industry was possible via even shorter courses however a five or ten month course that has no prior educational or experience requirements falls well short of the body of technical proficiency and learning required of a profession or indeed for the sort of fees the industry charges consumers. Courses such as the one below[50] provided by the Registered Training Organisation Monarch are completed in around "five to eight months"[51] with no prior learning required. No high school completion, no prior relevant work experience. And they offer price matching! Assessment involves four multiple choice quizzes and four assignments. No exams.

[50] Available at http://www.monarch.edu.au/courses/financial-planning/diploma-financial-planning/
[51] According to advice given over the phone on 18 March 2014

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Diploma in Financial Planning – Detailed Pricing

You can choose to enrol in the FULL Diploma of Financial Planning or alternatively you can enrol in just individual units (see prices below). There are substantial savings when enrolling in the Full Diploma of Financial Planning.

Diploma units	Distance (self paced) Education	Face to Face (workshops)^
DFP1 Foundations of Financial Planning	$475	$950 – 2 days
DFP2 Investments	$475	$950 – 2 days
DFP3 Superannuation & Retirement Planning	$475	$950 – 2 days
DFP4 Insurance & Risk Management	$475	$950 – 2 days
FULL Diploma Enrol in the FULL Diploma and save!!	$1,425 – we price match!	$2,950 – 8 days – we price match!
HUGE SAVINGS	Quality education, now more affordable	Quality education, now more affordable

Entry to the industry falls well short of consumer expectations and well short of the standards required to create an advice profession and we urge the Inquiry to address this issue.

11.4 High standards of ethical and professional conduct

Ethics really matter in this industry because the products and advice are complex and information asymmetry is extreme. This makes clients are very dependent on advisers, but the evidence is clients don’t know good advice from bad advice. ASIC 2013 Retirement Advice Shadow Shop found bad advice delivered by a charming individual is thought to be good advice and good advice delivered in a forthright manner by a robust individual is viewed as bad advice.

The sector has attempted to self-regulate in this area for some time, with the FPA developing a code of conduct that is reasonable on content but falls short on administration, monitoring and accountability. In contrast to the FPA run code the banking and insurance industry codes are independently administered and monitored, with consumers having a role in these key functions.

To establish consumer confidence industry codes must not simply repeat the law but must elaborate best practice compliance with the law and in terms of difficult ethical issues set standards that go beyond the law and meet consumer expectations. For example consumers desire for the so called opt-in practice could be developed via an industry code which could set out an agreed pathway (for consistency) for members who wish to comply with this higher standard.

ASIC has a policy statement on self-regulatory codes of conduct and given the crisis of confidence we think requiring financial advice sector codes to comply with that policy would help.

11.5 Conflicts of interests – percentage charges

FoFA does not remove all forms of conflicted remuneration and the recent changes have reinstated conflicted remuneration.

FoFA didn't tackle asset based fees or percentage fees – it only banned these on geared products where the conflict was too obvious to ignore.

Percentage based so called "fees" will stand in the way of professionalism because they are effectively commissions by another name, though they do have the advantage that clients can actually turn them off.

Asset based fees incentivise advice towards assets from which a fee can be deducted. They work against the provision of strategic advice.

Percentage fees obscure the full cost of advice. They result in consumers paying too much and they erode savings as costs escalate over time. While ever asset based charges are the dominant form of charging the reputation of the whole industry will suffer in consumers eyes and confidence will be diminished.

Asset based fees are impacting on consumer confidence.

11.6 Conflicts of interests – ownership and vertical integration

FoFA did not address all structural conflicts in business models and FoFA has spurned consolidation in the sector that has increased structural conflicts to consumers.

In response to FoFA we have seen massive consolidation in the industry with five conglomerate institutions, which both make and distribute product, owning 85% of advisers who are known as the distribution arm. However a number of the remaining unaligned advisers set themselves up as platform providers. Both these forms of vertical integration create conflicts of interest as they create incentives through lower costs to the dealer group or institution to recommend in house products to consumers. While on one hand consumers may benefit from lower costs they do not get what they are think they are buying: independent advice specific to their personal circumstances that is in their best interests and their interests alone.

Vertical integration is a structural problem and causes conflicted and lower quality advice. Financial advice shadow shopping exercises by CHOICE and ASIC since the 1997 FSI have continued to reveal a strong link between poor advice and vertical integration. This has been made in every shadow shop report and most recently in ASIC's 2012 shadow shop report[52] where it said under the heading **ownership by or association with product manufactures**:

"These conflicts of interest were present in the financial advice we reviewed in the shadow shopping research study. For example, 66% of the advice examples involved the recommendation of in-house products or products associated with the advice group. Of these, 11 of the 13 advice interactions with advisers from one of the big four banks (or their financial planning divisions) resulted in an in-house product recommendation. While, in some cases, the products recommended may have been equivalent to or better than the client's existing product, there were also cases where the in-house products recommended were relatively more expensive, or other reasons meant that the product switch was not adequately justified."

We urge the inquiry to make recommendations to phase out the structural conflicts of interest created by vertical integration of product making and advice.

[52] Shadow shopping study of retirement advice March 2012 report 279 available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep279-published-27-March-2012.pdf/$file/rep279-published-27-March-2012.pdf para 213

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11.7 Customer care and fulfilling promises

Another hallmark of a profession is care of the customer from the beginning of the relationship to the end of the relationship. Hence professions such as doctors and lawyers have developed various last resort funds to enable professionals to fulfil promises to customers when things go wrong.

The Wallis committee noted the adversity that accrues to individuals through broken promises and among the responses to Wallis was s912a and s912b of Corporations Law which requires financial services licensees to have compensation arrangements in place.

S912a requires external dispute schemes to provide compensation when licences are solvent, s912b requires licences to have arrangements in place to ensure consumers are compensated for loss when they are insolvent.

Regulatory guidance in respect of s912b requires licenses to hold professional indemnity. However the last decade has seen a thorough documentation of the failings of PII to provide consumer compensation[53] – indeed the product is not designed for this purpose at all.

Moreover the last of effective compensation arrangements are now impacting on the effectiveness of s921 a – external dispute resolution scheme and we will return to this point below.

However it is our view that a last resort compensation scheme along the lines of the UK Financial Services Compensation Scheme[54] which pays claims against financial services licensees when the firms are unable to. It does not cover market risk, rather it covers claims arising from breach of the law or other obligations on licensees.

Part of consumer's loss of confidence in the financial system and the super system more specifically arises from the significant amounts of uncompensated loss. This occurs not only in the big financial disasters but we are now seeing a dramatic escalation in unpaid determinations from the ASIC

[53] Eg see Joint consumer submission to Rihcard St John inquiry avaiable here http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/compensation_arrangements_report/default.htm and Finanicial Ombudsman Service sumbission http://www.fos.org.au/custom/files/docs/fos_response_to_richard_st_john_report_and_letter_july_2012.pdf

[54] http://www.fscs.org.uk/

approved external dispute resolution schemes – both FOS and the Credit Ombudsman scheme. We are not arguing for an extension of the SIS Act compensation arrangements to self-manage super because this part of the industry sits outside the prudentially regulated sector, but we do support access to compensation for breaches by intermediaries who assist consumers in the self-managed super sector.

The lack of a last resort compensation scheme is the missing piece of financial services regulatory architecture and marks us out from UK and European jurisdictions. Uncompensated consumer loss is a contributing factor to the loss of trust in the system and the industry.

2. Appendices

Appendix 1 – Combined business case and business plan for Superannuation Consumers Centre


OLIVER WYMAN

choice
THE PEOPLE'S WATCHDOG

CENTRE FOR SUPERANNUATION CONSUMERS
BUSINESS CASE

APRIL 2013

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