



## **Association of Financial Advisers Ltd**

**Formal response to ASIC on position paper –  
“Managing Conflicts of interest in the Financial Services Industry”.**

**The AFA notes with interest the grouping, by the ASIC, to collate a series of so called conflicts of interest and the management process they believe is necessary.**

**Firstly, the AFA is primarily committed to a free market in Financial Services with, of course, the appropriate legislative structures and compliance. Over regulation of the market will ultimately increase the price of the products to that market.**

**We have considered, at length, the comments and case studies and respond below to each of the areas where the Association has an interest.**

**As well, we are willing to meet with the ASIC and discuss further our response and concerns.**

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## **AFA response to each item:**

### **B3 Buyer of last resort.**

**B3.1** Wedgetail Allfinanz Limited is a major provider of banking, insurance, superannuation and fund management services. It has a large number of managed fund products and a large network of advisers who recommend its products to their clients. In its arrangements with many of these advisers, Wedgetail agrees to 'buy' their businesses on a 'last resort' basis. The purchase price is a multiple of the annual commission income stream, with a higher multiple payable for sales of Wedgetail's products.

#### *ASIC commentary*

**B3.1.1** The conflict here is that Wedgetail's advisers have incentives to recommend Wedgetail's products (which might or might not be appropriate to their clients' needs) to maximise the value of their businesses. The easiest and most reliable way to manage this conflict of interest is by not using this methodology to set a purchase price.

#### **AFA commentary:**

**The Financial Services Industry in Australia is dominated by the major banks and life insurance Companies. They have diversified their businesses and gained control of distribution which drives flows into their products. It is the Products that generate profit for these large players not the licensees themselves.**

**The AFA supports the ASIC view that BOLR schemes are used to focus product selection for clients to the products that retain the highest BOLR multiple.**

**The way to manage this conflict is disclosure to the client in a clear, concise & effective way and to ensure that BOLR methodology does not compromise the clients needs or best interests.**

**B3.1.2** For disclosure to be an effective part of managing this conflict of interest, the client must be able to make an informed assessment about how the conflict of interest might affect the adviser's product recommendations. In particular, the client should understand that the arrangement might result in a preference for recommending Wedgetail's products.

#### **AFA commentary:**

**The AFA agrees with the ASIC comment, the FSG & SOA must outline the relationship between the adviser, the licensee and the parent company.**

**B3.1.3** Wedgetail's internal controls should also ensure that the integrity and quality of the advice is maintained at a high standard. Wedgetail needs to be confident that all advice provided is appropriate and in the best interests of clients.

**AFA commentary:**

**The ASIC comments are correct. Wedgetail Group has major legal and reputation risks if they do not effectively manage this conflict. Thus disclosure and compliance regimes within Wedgetail need to be thorough and rigorous to ensure that the advice provided is always in the best interests of the client.**

**B4 Relationship between product issuer and adviser**

**B4.1** Wealthinvest, a product issuer, owns a financial planner group called Lark. Lark's advisers only advise on and sell Wealthinvest's products. Lark does not use any of Wealthinvest's branding or logos, but if you look closely enough on Lark's website there is a small paragraph which says that Lark is a wholly-owned subsidiary of Wealthinvest. Lark's financial services guide and statement of advice also say, in the fine print, that Wealthinvest owns Lark.

*ASIC commentary*

**B4.1.1** The conflict here arises because clients might not realise that Lark's services are restricted and that the advice that its advisers give is biased. Lark needs to be confident that, given the limited product range available to its advisers, it is still possible to provide advice that is appropriate and in the best interests of clients.

**AFA commentary:**

**The ASIC view is correct. Refer to AFA comments in B3.1.1.**

**Meeting client objectives and providing Quality advice is the focus here. Choice of product is important in fulfilling client needs. However, most investment platforms give a plethora of investment choice and Lark needs to have open architecture in risk and superannuation products.**

**Again, clear, concise and effective disclosure is the key here. The client needs to be aware of the relationship between the adviser, the licensee and the parent company.**

**B4.1.2** For disclosure to be an effective part of managing this conflict of interest, the client must understand the relationship between Lark and Wealthinvest and how that relationship affects Lark's advisers' product recommendations. The client should clearly understand that the adviser cannot recommend other issuer's products and that the advice will be limited and as such the client might suffer detriment.

**AFA commentary:**

**The ASIC comment is correct. This disclosure should be contained clearly, concisely and effectively so that clients understand the relationship "upstream".**

**The client also needs to understand that the Adviser's recommended list has been thoroughly researched and that there is a broad choice on offer.**

## **B5 Advice on platforms**

**B5.1** Jane, an adviser at Finco Super Pty Ltd, recommends to clients to switch to a wrap account provided by Leopard Financial Limited. Finco is a wholly-owned subsidiary of Leopard. Leopard's wrap account offers similar functions to the client's current platform, however it makes administration of the client's portfolio easier for Jane. Jane also gets up front and trailing commissions when clients switch to Leopard's platform.

*ASIC commentary*

**B5.1.1** In this case study, Jane is receiving a financial benefit in moving clients to the new platform in circumstances where there is no discernible benefit to the clients in making the move. Generally, moving clients to the adviser's platform merely because it makes it easier for the adviser to service the clients is not a sufficient reason to justify the switch. The new platform should be objectively better for the client (e.g. in the service it provides or in lower fees and costs) to justify a switch. If there is no discernible benefit, the commission should be rebated to the client.

**AFA commentary:**

**ASIC and case study is correct. The needs of the client are the primary obligation. Switching platforms must provide some benefit to clients. A more efficient advice practice may well provide better service and outcomes for clients whilst being cheaper and with broader choice for clients.**

**However, all this must be disclosed to the client and well researched by the Adviser. Any fee or commission also needs to be negotiated by the Adviser and the client and meet full disclosure requirements.**

**Advisers add value and meet client needs when they provide advice and strategy not just simply completing application forms.**

**B5.1.2** For disclosure to be an effective part of managing this conflict of interest, the client should understand the relationship between Leopard and Finco, the amount of commissions that Jane will get as a result of the switch, the differences between the two platforms, including the advantages and disadvantages of the switch and the reasons why the adviser considers the switch suitable.

**AFA commentary:**

**ASIC comment is correct. The AFA recommends that the SOA contain clear guidelines as to the reason and purpose of the switch as well as the relationship between adviser, the licensee and the manufacturer.**

**B5.1.3** Finco's internal controls should also ensure that despite the biasing influence of the ownership structure, all advice provided is appropriate and in the best interests of clients. Effective supervising and monitoring of the advice provided is an important part of this.

**AFA commentary:**

**ASIC comment is correct. This is the mandate of licensee management and compliance teams. The most valuable component of the advice comes from providing strategic advice, not from using platform A over Platform B.**

## **B6 Dial-up/dial-down fees**

**B6.1** An adviser regularly recommends a platform product that allows the adviser to select the entry and ongoing fees that the product issuer pays to the adviser from the client's account. This results in clients paying higher fees than they would if other comparable products that do not have this 'dial-up' option had been recommended.

*ASIC commentary*

**B6.1.1** The adviser must reasonably believe the recommended product is suitable for the client. If both products are suitable, clear disclosure of the different features and fees for both products can help manage the conflict.

**AFA commentary:**

**Clients are paying advisers for advice, service and implementation. The Platform has become a convenient mechanism for collecting this income. As long as this is disclosed to the client and agreed upon by both adviser and client then this is a viable client adviser relationship.**

**The AFA recommends that the market will determine what clients will and won't pay for. As long as it is disclosed value, this will be the determining issue in the clients mind.**

**B6.1.2** The licensee's internal controls should also ensure that despite the incentive to recommend a product giving the adviser discretion over the fees charged, all advice provided is appropriate and in the best interests of clients. One way to help achieve this is by review and monitoring of advice by supervisors.

**AFA commentary:**

**The AFA disagrees with this approach. It is already in place with compliance teams within licensees, spot audits and the reporting of any breaches to ASIC. The AFA believes this is fulfilling the need to ensure that appropriate advice is delivered to clients.**

**B7 Shelf fees**

**B7.1** Yellowhammer, a popular issuer of managed fund products, pays a fee to Buffalo, a large financial planning group to have Yellowhammer's products on Buffalo's approved product list. This fee is in addition to the normal commissions that Yellowhammer pays for the sale of its products.

*ASIC commentary*

**B7.1.1** The conflict here is the potential that Buffalo has Yellowhammer's product on its approved product list because of the shelf fee and not because the product is appropriate for Buffalo's clients. The only way to manage this conflict of interest is to avoid it. The incentive for Buffalo to put Yellowhammer's products on the approved product list because of the shelf fee might mean that comparable or better products, that do not pay a shelf fee, are not considered.

**AFA commentary:**

**The AFA agrees with ASIC's comments on this issue.**

**B8 Payments for switching funds**

**B8.1** Hyena Financial Management Limited, a product issuer, offers an adviser a \$175,000 fee to switch all of her clients from a competitor fund to Hyena's Cheetah fund. The fee represents a substantial sum for the adviser and she finds it impossible to resist the offer, even though the Cheetah fund has had higher fees and lower returns for the last 3, 5 and 10 years, respectively, than the competitor fund. The adviser nonetheless recommends the switch and rebates part of the fee to the clients.

*ASIC commentary*

**B8.1.1** There is a clear conflict of interest in this case between the adviser and her clients as the only basis for the switch appears to be the fee payable to the adviser. The only way to manage this conflict of interest is to avoid it. Rebating part of the fee to the client does not address the conflict of interest. Further, the adviser should only make recommendations that are appropriate for the client.

**AFA commentary:**

**The AFA agrees with ASIC's comments on this issue.**

## **B10 Bulky statements of advice**

**B10.1** Finplanco asks for advice from its lawyers about its statement of advice (SOA) template. A priority for Finplanco, in getting legal advice, is to limit its liability as far as possible. Finplanco's lawyers advise that Finplanco should put as much protective wording in its SOAs as possible to limit its legal exposure. This results in Finplanco's average SOA being about 65 pages long.

*ASIC commentary*

**B10.1.1** In this situation, Finplanco is putting its own interests above those of its clients. Clients are entitled to expected advice that is clear, concise and effective. Finplanco should go back to its lawyers and ask them to draft user friendly SOAs that are not full of dense legalese.

**AFA commentary:**

**The AFA fully supports the ASIC view but contends that ASIC needs to provide leadership on this issue. Overly long SOAs add significant cost to clients and deprives a large number of Australians from receiving appropriate advice as they cannot pay for it.**

## **B11 Super funds that don't pay commissions**

**B11.1** Jessica is an experienced financial planner working for AdviceNetwork, a licensee that operates a large network of advisers who do not charge fees for their services, but rely on remuneration from commissions. She believes that many of her clients would be better off in super funds that had low fees, good managers and above average historical returns.

**B11.2** However, because a lot of the super funds that fall into this category do not pay commissions, she cannot convince AdviceNetwork to include them on its approved product list. As a result, she never recommends that clients invest their super savings in any of these funds, but instead recommends funds that pay commissions.

*ASIC commentary*

**B11.2.1** There is a conflict here between the remuneration model adopted by AdviceNetwork and the provision of advice that is appropriate to its clients in all cases. The remuneration model forces AdviceNetwork to prefer commission-paying products over products that do not pay commissions. Ideally, this conflict should be avoided and is often only partly addressed by disclosure and control mechanisms.

**AFA commentary:**

**The ASIC statement is not correct. There may be a case for the use of industry super funds and the fact that they have low entry fees and pay no commission for advisers, but if you do not pay for advice you are not going to get any.**

**We suggest that the ASIC leave this issue to the market to determine.**

**In essence, people who choose to stay in an industry super fund do so because they have that choice. People who do not stay and move to funds where advice is provided and they pay for that advice in a fully disclosed manner, do exercise that choice as a consumer. ASIC, by this comment, is setting out to negate the choice of funds legislation.**

**Summary of comments on the ASIC Paper.**

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The ASIC has generated some interesting and timely exposure of events that have been in place for long periods of time.

The paper, however, is coloured by the desire to be all things to all people and to fully regulate the Financial Services Industry at a micro level rather than setting macro level regulations, such as no BOLR enhancements for internal product.

We support most of the comments and observations but believe that market forces in some cases will be more effective in meeting your desired outcomes.

Working together on these issues is a primary objective in order to have continued refinement and change to the benefit of the industry and the consumers.