Submission to Treasury Review of the quality of advice

Submission by Steve Melling, Managing Director
Paul Melling & Associates Pty Limited AFSL 231247

3rd February 2022

This submission is made in the context of two prior emailed submissions made to Josh Frydenberg and Jane Hume in 2019 and 2021 (attached to the end of this document). These two submissions related to a) the forced removal of grandfathered commissions from retail advice products (appendix a) and b) the imposition of "enhanced" (additional complexity) annual advice fee renewal requirements on all retail financial advice clients (appendix b). These two appendices form part of this submission.

A primary driver of financial advisers exiting the retail financial advice industry could be summarised simply as "it is simply no longer worth the time and risk" of continuing to operate these businesses.

Reduced revenue (commissions removed and low-revenue clients terminated) and **increased time wasted** (time spent on unnecessary and time-consuming compliance such annual renewal documentation and unnecessarily complex and high risk "Statements of Advice") make the endeavour no longer commercially attractive – with the notable exception of advisers who focus on high-net-worth clients.

With significantly reduced income, significantly increased time spent on meaningless tasks and the risk that it could all disappear with the stroke of a regulators pen, it is not surprising that so many advisers, even those with long-standing client bases and well established businesses, are considering whether there are less stressful ways of making a living than providing financial advice to average "mum and dad" retail clients.

What should be done?

<u>The following should be implemented without delay:</u>

1) **Removal of the "opt-in" annual renewal requirements and annual "trustee consents" but retain annual fee disclosure.**

   All financial advice clients already have the ability to Opt-Out of their monthly advice fees at any time – there is no need to additionally require them to constantly "Opt-In".

   This simple act (in combination with item 2 below) will restore the operational EFFICIENCY of the "commission system" without losing any of the TRANSPARENCY or INVESTOR CONTROL of the "fee system" - thereby allowing advisers to retain small-asset-value clients on their books at little cost and for those advisers to be available to these clients whenever they need advice or assistance (and without requiring an expensive, full "review" every single year).

2) **Allow platform providers to generate and provide annual fee disclosures to clients**.

At present, this obligation falls on the individual financial advisor (or their licensee), despite the fact that exactly the same fee information is provided anyway by the platform provider.

There is no logic in preventing the platform from performing these fee disclosure tasks.

A new definition: "Financial Advice Fee Intermediary" should be added to Corporations Act Section 9 – Definitions.

Section 962G should be amended to replace the words "Fee Recipient" with the words "*Fee Recipient or Financial Advice Fee Intermediary*" so that section 962G reads: *"Fee recipient or Advice Fee Intermediary must give fee disclosure statement…."*

3) Simplify annual fee disclosure documents

There is no need to complicate these documents with individual descriptions of services previously provided, details of services yet to be provided and unreliable forward projections of fees to be paid. Most advisers have standard service agreements arranged with clients – inclusion of these standard service details in the annual statement should be sufficient. Disclosure of the past year's fees (in dollars) plus the basis upon which fees are calculated (eg % of account balance) is all that is necessary, and keeps the process of disclosure both straightforward and accurate. As above, these documents can then be easily produced by the platform (or by the adviser if the adviser prefer to continue to produce these documents).

4) **Allow experienced financial advisers to continue to trade** where they have 10 years experience and financial planning qualifications (such as Diploma of Financial Planning, Certified Financial Planner). Current FASEA rules require such advisers to complete a new degree (with varying levels of exemptions) if they are to continue beyond 2025.
These advisers should simply be required to complete the single "Ethics" subject plus pass a (improved and more relevant, see point 5 below) Financial Adviser exam.

Advisers with 20 years experience but without financial planning qualifications should be allowed exemption from the educational requirements, with the exception of the Ethics subject and Financial Adviser exam. These suggestions have been made in a separate Submission to Treasury in relation to Financial Adviser Education Standards.

The following should be implemented as soon as is practical – perhaps from 1-July-2022:

5) **Fix the "FASEA" exam (Financial Adviser Exam).**

The current "FASEA" exam is only vaguely relevant to a financial advisers role. Much of the FASEA exam is geared towards licensees and compliance staff, not financial advisers. Advisers should be able to sit an exam which is suited to their areas of specialisation – for example, Stockbroking, Insurance, Accumulation (pre-retirement) planning, Retirement Planning or aged care – or a mixture of these areas of specialistion.

A compliance-focussed exam (focussing on the Corporations Act, Privacy Act, etc – as per the current FASEA exam) should be required to be passed by compliance and licensee staff (such as Responsible Managers and Directors of licensees) only.

6) Replacement of complicated and legally verbose "Statements of Advice" with a less prescriptive "Letter of Advice" or "Customer Advice Record".

These documents should include details of any fees or commissions, and disclose any material conflict of interest, but should be assessed on the basis of providing financial and advice and financial product recommendations which are suitable and appropriate to the client based on the client's needs and desires. In short, a requirement to "know your client", "know your product" and to provide advice which is subject to a "suitability test" when recommending products to ensure that they are aligned with the client's interests. This concept worked well for many years prior to the introduction of SOA's.

7) Acting in the interest of the client – removing the impossible standard of "best interest".

Whilst at first glance no-one could argue against the principal of acting in their clients "best interests", this leaves open an unknown and (without the benefit of hindsight, unknowable) legal liability. This is exacerbated by the requirement of Section 961B (2) (g) to also take *"any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client…".*

Statements of Advice have thus become defensive legal documents, full of disclaimers, product comparisons and excessive verbiage designed to protect against legal challenge at a later date.

It is impossible to know in advance which of many possible investment products will be the "best". Yet this is the wording of the legislation, which can then be used against the adviser by an aggressive lawyer or regulator. No wonder many SOAs are so verbose yet unhelpful to the client's understanding of the advice being given.

Section 961B of the Corporations Act should instead require the advice provider to "act in the interest of the client" which is aligned with the common law principles well established in this area.

Section 961B of the Corporations Act should be amended to replace the words "Best Interest" with "Interest" where these words appear. Failing this, Section 961B (2) (g) of the Corporations Act should be removed at the very least.

8) **Remove of Strict liability and potential jail terms for minor administrative errors.**

The maximum penalty for not providing (for example) a single Financial Services Guide (FSG) or failing to even provide evidence of having provided an FSG to a retail client, and other administrative "crimes" under section 952C(1) is 5 years imprisonment. Further, this is a strict liability "offence" with no regard for intent or error.

Strict Liability for these so-called "offences" must be removed so that there must be some level of ill-intent before such penalties apply – advisers should not have to fear being jailed for 5 years for administrative errors such as failing to keep a record of proof that an FSG, SOA etc has been provided to every client.

I hope these suggestions are received in the spirit in which they are made – a desire to repair and rebuild a sustainable financial advice industry to serve the millions of Australians who can benefit from an ongoing relationship with a qualified, experienced and professional financial adviser.

About Paul Melling Retirement Planning and Steve Melling

Paul Melling Retirement Planning was established by Mr Paul Melling in the mid 1980's and has provided retirement planning advice and peace of mind to thousands of Australian retirees. Steve Melling joined his father Paul in the business in 1994 and has now been with the business for over 25 years.

Paul Melling is a Fellow of the Institute of Actuaries (London). He has retired from an active role in the business. Steve Melling holds an undergraduate degree in Economics and holds post-graduate qualifications in Superannuation, Applied Finance and Investment and in Corporate Governance.

Steve also holds Masters degrees in three fields - Banking and Applied Finance, Banking and Financial Services Law and in Systems Administration. Steve is a CFA Charterholder and a CAIA Charterholder.

Appendix A

From: Steve Melling
Sent: Thursday, 28 January 2021 3:37 PM
To: 'Josh.frydenberg.mp@aph.gov.au' <Josh.frydenberg.mp@aph.gov.au>; 'senator.hume@aph.gov.au' <senator.hume@aph.gov.au>
Cc: 'senator.paterson@aph.gov.au' <senator.paterson@aph.gov.au>
Subject: Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020

Dear Josh,

I write in relation to the "***Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020***" which you introduced to the House of Representatives in December.

As you are aware, ASIC recently released Consultation Paper 332 – Promoting Access to affordable advice for consumers, and asked for responses.
I have attached an excellent response paper produced by experienced financial adviser Steve Blizard. I could not have written it better myself.
Whilst the response is worth reading in full, the following points cannot be emphasised enough:

Annual Opt-In … forces advisers to only consider … clients who are able to pay them enough so that they can deliver enough ongoing services to a client in a year to get them to actively opt-in.

The Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020, specifically requiring retail advisers … to seek annual fee renewals, will simply increase the cost for
low-income families to access advice services, and will reduce the amount of advice reviews and service support these families could have received during their lifetime. Private Banking Divisions have already withdrawn advice services to the elderly and low income retail clients due to excessive regulatory requirements.

The government should repeal the opt-in requirement (or make it less frequent than every year).

As it stands, your proposed **Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020** is headed in exactly the wrong direction and will be the final nail in the coffin for thousands of retail advisers and their businesses.
Given the significant damage already done to the lives and mental health of so many in the industry as a result of Mr Hayne's opinions, it may also be the literal nail in the coffin for more advisers in the years to come.

It is time to cease putting the highly biased opinions of one person (Kenneth Hayne) and his staff before the experienced views (and common sense) of thousands who work in the retail advice industry **and their clients**.

As it stands, your proposal will simply result in personal financial advice being available only to those who are sufficiently wealthy to either 1) qualify as wholesale or 2) pay enough in fees to justify the compliance risk involved with the constant production and follow-up of opt-in notices.

All financial advice clients already have the ability to Opt-Out at any time – there is no need to additionally require them to constantly "Opt-In".

You have done so much to support Australian business over the past year – please consider extending this supportive approach to the retail financial advice sector.

Kind regards,

Steve Melling
Managing Director
Paul Melling Retirement Planning
1/486 Lower Heidelberg Road
Heidelberg Victoria

CC: Senator Jane Hume
Senator James Paterson

Appendix B

From: Steve Melling
Sent: Tuesday, 30 July 2019 1:48 PM
To: senator.hume@aph.gov.au <senator.hume@aph.gov.au>
Subject: Comments on the proposed forced removal of grandfathered commissions on all retail financial advice client accounts

Dear Senator Hume,

My apologies for not including you in this original email (below) – I have just read that the proposed introduction was a joint press release.
I am unfortunately not experienced or familiar with the process of communicating on proposed government legislation.

I hope that have the opportunity to consider these comments. It is perhaps too late but I feel I could not just watch this happen without at least giving my view and a suggestion for improvement.

All the best,

Steve Melling

From: Steve Melling
Sent: Tuesday, 30 July 2019 1:36 PM
To: Josh.frydenberg.mp@aph.gov.au; senator.paterson@aph.gov.au
Subject: Comments on the proposed forced removal of grandfathered commissions on all retail financial advice client accounts

Dear Josh,

I write in reference to your intention to introduce legislation to force the removal of grandfathered commissions from all retail client accounts.

I commend the spirit in which the proposed legislation is being introduced – to improve member outcomes.

However, as a result of this legislation many thousands (likely hundreds of thousands) of retail clients who have previously enjoyed the benefits of having a financial adviser available to them to assist them as required, will no longer be able to enjoy this benefit.
You are no doubt already aware of the reasons for this – the administrative and compliance cost (and compliance risk!) of operating on an ongoing adviser fee basis is significantly higher than the cost of providing ongoing, ad-hoc advice on a commission basis.

For many “smaller balance” clients in particular, the cost and in particular the risk to financial advisers of operating on an ongoing fee basis will make them unwilling to continue to provide financial advice to these clients - resulting in them becoming “advice orphans”. This will not be a problem for wealthy clients.

I make the suggestion that if you wish to improve client/member outcomes (for these “smaller” clients in particular), you should give members the choice of continuing on a commission basis, or of having the commission refunded to their account (and therefore no longer able to access an adviser without an explicit fee).

This choice can only benefit fund members. If you are concerned that fund members will not make an informed choice, it would be reasonable to establish the Default position that commissions be turned off (and refunded to the member) where they did NOT elect to continue to have the commission paid to the adviser. This election by the member to retain the commission should be only required once, but the member must always retain the right to withdraw consent to have the commission paid to their adviser any time (at which point the commission must be paid to the members account).

Thousands of excellent, trustworthy and experienced financial advisers have operated on this basis of implied service for decades – if you don’t look after the client, they will go elsewhere (and the commission will leave).
This is how business should be run – happy clients mean a successful business. No government intervention necessary.

I suggest that instead of introducing legislation to remove this happy relationship (for so many) by force of law, without the consent or approval of either client or adviser, you instead introduce law to reinforce the voluntary and consensual nature of a good client-adviser relationship, without the administrative and compliance overhead – and instead seek to **introduce legislation which removes grandfathered commissions only for investors who do NOT elect to continue the grandfathered commission relationship**.

I hope that you can see the logic in this approach.

I would of course be happy to discuss this proposal in more detail if this would be helpful.

All the best,

Steve Melling
Managing Director
Paul Melling Retirement Planning

CC: Senator James Paterson