Senate Select Committee on Financial Technology and Regulatory Technology

FSC submission

January 2020

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1 About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2 Introduction

The FSC welcomes the opportunity to submit to the Senate Select Committee on Financial Technology and Regulatory Technology's **("the Committee")** inquiry. Financial and regulatory technology has a foundational role in Australia's financial services. The FSC in submitting to this inquiry comments and makes recommendations across four areas:

- Superannuation
- Product modernisation
- Anti-money laundering
- Financial advice

2.1 List of Recommendations

The FSC recommends the Government:

- Ensures the Open Super framework centres on enabling individuals to access their own, tailored data and be a core focus in extending the Consumer Data Right. (This is discussed further in Section 3.1).
- Delay the development of Open Super until 2022 to allow the appropriate level of resources to be dedicated to this important reform. (This is discussed further in Section 3.3).
- Prioritise an update of the laws governing super and other industries to ensure these are technology-neutral and fin-tech ready. (This is discussed further in Section 3.4.1).
- Consider the alignment of data-collection by Regulators as part of reforms to ensure a robust regulatory net for fintech and regulatory technology and to prevent an undue impact on consumers. (This is discussed further in Section 3.4.2).
- Introduce a comprehensive product modernisation (or product rationalisation) scheme for legacy products in financial services. The Government has a long-

standing commitment (made in 2015 in the Government's response to the FSI)[1] to implement such a scheme for life insurance and funds management, and the FSC advocates for extending this commitment to superannuation. (This is discussed further in Section 4 below).

- Explore the appropriateness of an institutional mechanism (e.g. tribunal) that would allow for expert independent decision-makers to approve rationalisation of products. This would help address the concerns of both consumers and industry by providing greater certainty, transparency and timeliness around a process that has historically proved difficult to negotiate. (This is discussed further in Section 4).
- Work with industry to resolve uncertainty surrounding the legal nomenclature personal and general advice and broader policy questions of what falls within and out of general advice. (This is discussed further in Section 6).

3 Consumer Data Right for superannuation

The FSC is generally supportive of extending the Consumer Data Right (**CDR**) to superannuation.

However, it will be important to clearly understand what extending the CDR to create an "Open Super" framework is intended to achieve, particularly from a consumer perspective, to ensure that it is implemented effectively.

Consideration should also be given to the timing of such a change given there may be other sectors where greater consumer benefits would accrue from an open data regime.

3.1 What is Open Super?

The Productivity Commission recommended extending the CDR to superannuation in its 2019 report *Superannuation: Assessing efficiency and competitiveness*. We note that the government has yet to respond to the majority of recommendations in this report.

The Productivity Commission recommended that superannuation funds should be eligible to receive information as part of the Open Banking regime, as well as making superannuation data available to members.

Given there is already substantial data collected in relation to superannuation products and transactions it will be important to:

- Agree to the types of superannuation data that will be useful to consumers and should be included in an Open Super framework;
- establish what data already exists, and ensure that an Open Super framework does not duplicate existing data collection activities; and,
- ensure the Open Super regime is sufficiently compatible with existing data standards.

[1] See inquiry recommendation 43 – legacy products, and the Government's response outlined here - https://www.treasury.gov.au/publication/government-response-to-the-financial-system-inquiry/attachment-government-response-to-financial-system-inquiry-recommendations

A significant amount of product-level data is currently collected and published by APRA, with a new data collection process for choice superannuation products currently being developed. The ATO also collects account and transaction data, much of which is made available directly to consumers through MyGov. Wherever appropriate, this existing data should be used to facilitate Open Super.

There will be significant risks of duplication of data collection if the development of Open Super is not properly considered in the context of both consumer needs and existing data. This will increase the cost of implementation without delivering any benefit to superannuation fund members. Ultimately, the value added by an Open Super framework will centre on the ability for individuals to access their own, tailored data. Enabling access to this data should remain the core focus in extending the CDR.

FSC Recommendation: The FSC recommends the Open Super framework centres on enabling individuals to access their own, tailored data and be a core focus in extending the Consumer Data Right.

From a consumer perspective, we envision that an Open Super regime is likely to have the most significant positive impact in relation to accessing data for the purpose of receiving financial advice, making it easier for an adviser to understand the financial circumstances of their client. This will be particularly critical considering that our population is ageing and reportedly 700 Australians are retiring every day.[2]

3.2 Existing infrastructure

Over the last several years, the superannuation system has undergone major reforms to design and implement data transfer frameworks across the superannuation system. The learnings from the development of the Superannuation Transaction Network should be applied to the development of Open Super, and the existing infrastructure leveraged as far as possible to avoid duplication.

This includes consideration of:

- appropriate architecture for an Open Super regime, designed in conjunction with key stakeholders;
- agreed data standards which align with those currently in use;
- controlled data access, to balance the desire to keep barriers to entry low while applying appropriate data protections; and
- the need for ongoing governance arrangements for the collection, use and storage of consumer data.

[2] *The Australian*. Super problems stay unsolved. See: https://www.theaustralian.com.au/news/super-problems-stay-unsolved/news-story/c50e8969af977255bbff7cd301d8c290 (February 2016)

These issues are dealt with in greater detail in the submission made by the Gateway Network Governance Body **(GNGB)**. The FSC is a co-sponsor of the GNGB and is supportive of the GNGB's submission.

3.3 Timing

A significant pipeline of reform is currently underway in the superannuation system. The implementation of Open Super should be viewed in the context of these reforms, and the risks created by a rushed implementation timetable.

On balance, the FSC believes other reforms flagged by the Productivity Commission and Royal Commission are likely to offer a greater benefit to consumers, including the implementation of a 'default once' system for default superannuation.

It will also be important to learn from the experience of the Open Banking implementation and ensure that appropriate time is allowed for development and implementation of Open Super.

FSC Recommendation: The FSC recommends the Government delay the development of Open Super until 2022 to allow the appropriate level of resources to be dedicated to this important reform.

3.4 Related reforms

Extension of the CDR to superannuation should be supported by other reforms as required to ensure that superannuation legislation is technology-neutral, and consumers are able to engage with and manage their superannuation online if they choose.

3.4.1 Technology neutral legislation

The *Superannuation Industry (Supervision) Act 1993* (**"the SIS Act"**) does not consider electronic communications, and Schedule 1 of the *Electronic Transactions Regulations 2000* excludes most communications required by funds under the SIS Act from coverage under the *Electronic Transactions Act 1999*.

This means that funds cannot rely on electronic means of communication such as email, SMS or apps to contact members. It also means consumers are often unable to provide consent for changes to their superannuation arrangements by electronic methods, creating a barrier to engagement. To realise the benefits of access and efficiency for consumers fintech offers, updating the laws governing super as well as other industries to ensure these are technology neutral and fintech ready should be a priority for policymakers.

FSC Recommendation: The FSC recommends the Government prioritise an update of the laws governing super and other industries to ensure these are technology neutral and fin-tech ready.

3.4.2 Regulatory cooperation

In our view, the matter of data collection and requests by Regulators is important to industry with ultimate impact on consumers in terms of costs.

FSC Recommendation: The FSC recommends the Government consider the alignment of data-collection as part of reforms to ensure a robust regulatory net for fintech and regulatory technology and to prevent an undue impact on consumers.

4 Product modernisation

Australians have significant amounts of money trapped in out of date financial products that can result in poor customer outcomes. These legacy products are technologically out of date, and inhibit Financial Technology (**FinTech**) innovation for two main reasons:

- customers usually are unable to exit from these products and move into modern products, including FinTech products; and
- financial service providers are reluctant to innovate in case they create a product with low take-up that in future become out of date (legacy) products.

More broadly, numerous Australians are being substantially disadvantaged by being locked in to these legacy products that lack the better returns, better features and easier access of more modern products. Financial services businesses are unable to move customers into more modern products for reasons including large tax or social security penalties (the numerous reasons for product lock-in are detailed in Section 4.3 below).

Acknowledging this problem, the Government some time ago (2015) announced it would implement a comprehensive product modernisation (or product rationalisation) scheme for legacy products in financial services. <u>The FSC is urging the Government to implement this already existing commitment, which is now clearly overdue.</u>

4.1 Legacy products are an extensive (and expensive) problem

The Productivity Commission in its 2019 report into the superannuation industry[3] highlighted the extent of the problems caused by legacy products in superannuation alone. It found in 2017:[4]

- there was $162 billion invested in legacy superannuation products, which is 10% of the total assets held in APRA-regulated funds.
- there were 3.2 million legacy member accounts, which is 12% of the total for APRA-regulated funds.

[3] Productivity Commission (2018) *Superannuation: Assessing Efficiency and Competitiveness*, Report no. 91

[4] Productivity Commission (2018), Page 115 except where stated.

- This implies around 2.0 million individuals were trapped in legacy superannuation products with poor returns, based on the number of duplicate accounts in 2017.[5]

- Legacy products made up 46% of the assets in the high fee tail of products, with about 2 million member accounts; and almost all legacy products have high fees. The average fee in this tail was 2.2%, which is more than three times the most prevalent (i.e. modal) fee of 0.7% (see page 180).
- The number of products in the high fee tail has remained steady over time (see page 180 of the report). This implies that it cannot just be assumed that the issue of legacy products will gradually disappear over time (see further discussion in Section 4.4 below).

The figures above do not include legacy products outside of superannuation such as life insurance and managed funds, which are likely to be substantial. Earlier estimates of the extent of the issues are contained in previous FSC submissions[6] and the FSC is planning to conduct a survey of our members to update these figures in 2020.

4.2 Adverse impact of legacy products

There are numerous adverse effects from legacy products. In general, legacy products when compared to modern products can have:

- lower net returns, in many cases resulting in lower retirement incomes.
- higher fees – often significantly higher. The Productivity Commission evidence referred to in Section 4.1 above shows legacy products in superannuation have fees that are more than three times the most prevalent fee rate.
- poorer consumer disclosure and reporting.
- increased likelihood of errors, as many processes have to be completed manually.
- worse regulation for consumer targeting and suitability, as legacy products were sold before the introduction of the Design and Distribution Obligations regime.
- worse technology and reduced accessibility, for example they are not accessible through the internet or via apps.
- reduced resilience, as systems are out of date and expensive to maintain.
- reduced financial services innovation:
  - innovation can create legacy products, because a pioneering financial product may have low take up, and as a result be closed to new members. These products will then over time become legacy products – and the lack of a modernisation scheme will mean customers are trapped in the products and

[5] There were about 1.6 accounts per person in 2017, see: https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/Super-accounts-data/Multiple-super-accounts-data/

[6] For example see FSC Pre-Budget submission for 2018–19, available from: https://consult.treasury.gov.au/budget-policy-division/2018-19-pre-budget-submissions/consultation/download_public_attachment?sqId=question.2017-09-12.3768452384-publishablefilesubquestion&uuId=596571344

- the products eventually become out of date and costly to operate. Businesses can avoid this risk if they avoid innovation.
  - this is especially a problem for long-dated products such as innovative retirement income products which can easily become legacy products if take-up is low (see also the discussion in Section 4.4 below).

For detail on other adverse impacts of legacy products refer to Section 7.1.

4.3 Barriers to product modernisation

It might be thought that financial services businesses could just transfer customers out of inferior legacy products. However, there are various taxes, rules and regulations that prevent this occurring, including:

- Legal requirements that stop providers from changing consumer rights without explicit consumer consent. Broadly, superannuation deals with this issue in some circumstances – but this issue is not addressed outside of super.[7]
  - There are often significant legal barriers to product modernisation in managed funds and life insurance. For example, the provisions in individual fund constitutions within an investment product may not allow for transferring holdings/rights to another trust.
- Consent may be required from individual members including those that are uncontactable.
- Transferring only some members to modern products might make those members better off but might make the remaining members worse off (because high costs are spread over fewer remaining members), making the transfer calculations more problematic.
- The imposition of Capital Gains Tax (**CGT**) on unrealised gains. This tax can be imposed on the consumers holding the relevant legacy investment product, and also on the vehicle making the investments.
  - CGT relief is available for merging superannuation funds, but only for transfers that are executed as a 'single arrangement' that occurs within a single tax year. This means relief is not available where there are too many members to transfer in one tranche for operational reasons.
  - The CGT issue remains unaddressed for the modernisation of products within a super fund, for life-backed superannuation products, for life insurance products, and for non-superannuation investments.
  - There is also generally an inability to transfer capital losses to new products.
- State stamp duty on investments that back a product (whether super or non-super). Stamp duty typically applies to land held through unit trusts and companies. The CGT rollover relief for merging super funds noted above does not deal with the stamp duty issue.
- For life insurance bonds, potential for re-starting of the 10 year rule.

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[7] See FSC submission to 2019–20 Budget.

- Legal barriers that restrict the ability for product providers to communicate with members of legacy products about contemporary products.
- Possible loss of legislated member elections/decisions, for example binding death benefit nominations and elections as a result of the Protecting Your Super **(PYS)** and Putting Members Interests First **(PMIF)** legislation.
- In some cases, any customer transition to a modern product must be done with client consent, generally based on financial advice. Given the cost of personal advice, this may act as a significant barrier to rationalisation.
- Loss of grandfathered social security treatment. For example (highlighting added):

> *a person who is an owner of an account-based pension purchased before 1 January 2015 and the holder of a CSHC [Commonwealth seniors health card] on 31 December 2014, will not have their account-based pension included in the income test for as long as they: continue to hold a CSHC,* ***and retain the same account-based pension****.*[8]

To emphasise the points above, product modernisation relating to superannuation still faces numerous barriers even though some components have been addressed.

4.4 The problems of legacy products are unlikely to disappear

There is a perception that legacy products are a 'one off' problem that will gradually solve itself over time, for example as customers of legacy products withdraw remaining balances in the products. As a result, it might be thought that inaction on this issue is less of a concern. However, this view does not fit with the data outlined in Section 4.1 above showing the number of legacy products has not declined over time.

The Productivity Commission has also stated there is "strong risk that the incidence of legacy retirement products will rise".[9] They reached this conclusion because:

- product innovation and policy developments suggest annuities and pooled investments will grow in prominence;
- products will reflect tax and social security policy settings at the time of issuance; and
- as these settings change, or if innovative products fail to gain sufficient interest, some products may become obsolete.

4.5 History of product modernisation proposals

The has been a long-standing recognition of the need for a product modernisation scheme to allow consumers to move from legacy products to newer products. The FSC first put forward

[8] See: https://guides.dss.gov.au/guide-social-security-law/3/9/3/31
[9] See Productivity Commission (2018), page 216.

a proposal for a product modernisation scheme to the Government in July 2005 and in other forums since then.[10]

A product modernisation scheme was an important recommendation of the FSI final report in 2014:[11]

> ***Recommendation 43: Legacy products***
>
> *Introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance and managed investments sectors.*

In response to the final report, the Government made the following commitment in 2015:[12]

> *The Government agrees to facilitate the rationalisation of legacy products, in light of consumer, constitutional and fiscal issues.*
>
> *It is important that consumers should not be worse off due to any transition to a newer product. Under the existing framework there are possible tax implications of facilitating the transition away from legacy products, which will be explored in the context of the Government's Taxation White Paper process.*

Product rationalisation has been affirmed a number of parliamentary reports, government background papers and broader inquiries such as:

- **Rethinking Regulation – Productivity Commission** - 2006[13]
- **The Super System Review (the "Cooper Review")** - June 2010:[14]
- **ASIC's Submission the interim report of the Financial System Inquiry (FSI)** in August 2014:[15]
- **ASIC Report 466 Work to reduce red tape** – January 2016[16]
- **APRA's Submission to the Senate Economics Committee's Inquiry into the Scrutiny of Financial Advice – Life Insurance –** April 2016. [17]

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[10] For example: Phase Two submission to FSI; and Product Rationalisation — Managed Investment Schemes and Life Insurance Products Proposals Paper, 26 February 2010.
[11] See: http://fsi.gov.au/publications/final-report/executive-summary/#recommendations
[12] See: https://static.treasury.gov.au/uploads/sites/1/2017/06/Government_response_to_FSI_2015.pdf
[13] Rethinking Regulation: Report on the Taskforce on Reducing the Regulatory Burden on Business (January 2006) See: https://www.pc.gov.au/research/supporting/regulation-taskforce/report/regulation-taskforce2.pdf
[14] See: https://treasury.gov.au/review/super-system-review
[15] See: https://download.asic.gov.au/media/2613736/asic-submission-to-the-financial-system-inquiry-interim-report-published-26-august-2014.pdf
[16] See: https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-466-asic-s-work-to-reduce-red-tape/
[17] See: https://www.aph.gov.au/DocumentStore.ashx?id=790eec66-f56a-4f2f-96d3-8eb6a8f65114&subId=412976

- **Parliamentary Joint Committee on Corporations and Financial Services into the Life Insurance Agency –** March 2018[18]
- **Productivity Commission's Inquiry into Superannuation** – 2018[19]
- **Background paper on the Life Insurances Industry – Australian Government The Treasury** – August 2018[20]

For more information refer to Section 7.2.

Despite these observations, no noticeable progress has been made on a regime for product modernisation.

4.6 FSC's recommended product modernisation solution

The FSC's recommended approach for the modernisation of legacy financial products is:

- a consumer interest test applied at a collective level;
- transfer of non-tax attributes (e.g. social security benefits such as account-based pension 1 Jan 2015 grandfathering).
- roll over of all tax attributes to the new vehicle; and
- no tax implications of the rollover itself.

The consumer interest test involves an independent determination that modernisation is in the interests of consumers collectively.

FSC Recommendation: Introduce a comprehensive product modernisation (or product rationalisation) scheme for legacy products in financial services. The Government has a long-standing commitment (made in 2015 in the Government's response to the FSI)[21] to implement such a scheme for life insurance and funds management, and the FSC advocates for extending this commitment to superannuation.

FSC Recommendation: To expedite the rationalisation of a large number of legacy products, the Government should explore the appropriateness of an institutional mechanism (e.g. tribunal) that would allow for expert independent decision-makers to approve rationalisation of products. This would help address the concerns of both consumers and industry by providing greater certainty, transparency and timeliness around a process that has historically proved difficult to negotiate.

[18] See: https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/LifeInsurance/Report
[19] Recommendation 23.
[20] See: https://financialservices.royalcommission.gov.au/publications/Documents/reforms-to-general-and-life-insurance-background-paper-27.PDF
[21] See inquiry recommendation 43 – legacy products, and the Government's response outlined here - https://www.treasury.gov.au/publication/government-response-to-the-financial-system-inquiry/attachment-government-response-to-financial-system-inquiry-recommendations

5 Anti-Money Laundering and Counter-Terrorism Financing

The current Australian Anti-Money Laundering and Counter-Terrorism Financing (**AML/CTF**) regime serves an important function and financial services providers have an important role to play in reducing terrorism financing and money laundering which is a key enabler of transnational, serious and organised crime.

We wish to raise with the Committee a broader policy matter for its consideration which could create an opportunity for Australia to become a leader in the regulatory technology sector. This proposal seeks to address critical pressure points underlying AML-CTF compliance being business cost and expense as well as consumer benefit. It is suggested that policy level consideration be given to:

1. a “central repository” of customer due diligence (**CDD**) be maintained which reporting entities could rely upon; and /or
2. a CDD in effect be treated as a “financial passport” within Australia and once customer identification had been affected, other reporting entities could rely on the satisfactorily completed CDD.

5.1 General observations concerning reliance on pre-existing CDD

There is an opportunity for Australian consumers and business arising from financial regulatory technology however there are barriers to the uptake of new technologies in the financial sector. One such opportunity concerns AML/CTF compliance where the barrier for uptake for would be constraints in legislation.

It seems to us that this is a matter which will necessitate changes to the law and detailed discussions with AUSTRAC. In this regard, we are mindful that it is necessary for Australia to comply with its FATF and other international obligations.

Our December 2019 submission to the Senate Legal and Constitutional Affairs Committee highlighted a potential barrier for the uptake in regulatory technology with regards to AML/CTF compliance, as it is not clear that the Anti-Money Laundering and Counter-Terrorism Financing and Other Legislation Amendment Bill 2019 (“the Bill”) assists in consumer usability or business efficiency. Indeed, because of the removal of the safe harbour and the retention of ultimate liability for the product provider in the majority of instances, it is doubtful whether the measures proposed to be introduced by the Bill would be adopted by many businesses. This is to be contrasted with the existing protection afforded where CDD is undertaken in the first instance by a financial advisor and the product issuer relies on that CDD process.

The critical pressure points here are business cost and expense and consumer benefit. Apart from the limited circumstances set out in the current legislation, a consumer acquiring products subject to CDD must be identified. This is potentially time-consuming and inefficient for the consumer. From a business perspective, there is an added layer of cost and complexity each time a CDD process is undertaken.

Accordingly, we suggest that at a policy level consideration be given to either or both the following options or similar approaches:

1. a "central repository" of CDD be maintained which reporting entities could rely upon if it were reasonable in the circumstances;

2. a CDD in effect be treated as a "financial passport" within Australia and once customer identification had been affected, other reporting entities could rely on the satisfactorily completed CDD; again, if it were reasonable in all the circumstances.

We appreciate that further investigation and discussion would be required to go forward with this proposal. As we have said, we also are mindful that it is necessary for Australia to satisfy its international obligations in this context. However, we would welcome any observations the Committee has concerning this suggestion. In addition, we are happy to advance the matter further by way of preliminary discussion with AUSTRAC.

6 Fintech and Financial Advice

The FSC's members welcome a financial and regulatory technology environment that helps ensure affordable and accessible financial advice for Australian consumers.

The Senate Inquiry is a timely occurrence as Advice businesses recalibrate their operations, products and services. The catalyst for this has been the need to adapt the recommendations of the Royal Commission as these are implemented, and incoming professional standards and education requirements for financial advisers. The parameters of personal and general advice have also been and remain the subject of Judicial inquiry.[22] How advice is defined is the subject of debate in the current operating environment. It will likely have greater focus when viewed in the context of financial and regulatory technology.

FSC Recommendation: The Government to work with industry to resolve uncertainty surrounding the legal nomenclature regarding personal and general advice and broader policy questions of what falls within and out of general advice. This is discussed in Section 6.

If the Government determines it is in the public interest to disrupt the financial advice industry in order to achieve a certain outcome (e.g. the provision of financial advice to a wider range of persons) then its role is do so with set policy initiatives. Given industry is innovating in this area already, government should avoid a scenario where two sets of rules emerge. The size of business should not constrain who is able to do this.

There remain impediments to innovation for advice businesses that an invigorated financial and regulatory technology sector could address. Removing these impediments could help industry generate innovative, low-cost, affordable advice products to those that need it most. The imperative to do so will become more essential as the population ages and the demand

[22] Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187 ('ASIC v Westpac') [1]

for those on middle to lower incomes for financial advice grows. Not addressing this need might add pressure to Australia's retirement income system in the future.

The Advice industry in five years will have changed not because of the policy and legal developments shaping it and ultimately, the entrepreneurship of its businesses. How fintech can add value to the client-adviser relationship; the role digital advice is already having; and the shape of new delivery models of advice; are the areas the FSC members prioritise in this discussion.

6.1 Client-adviser relationship

The very nature of client-adviser relationships is changing. Companies offering financial advice are already developing platforms that have changed and invigorated the services and value that consumers can access.

This relationship is also being changed by policymakers enabling an abundance of opportunities for fintech to harness in the right regulatory environment. For example, Royal Commission Recommendation 2.1, when implemented, will cease ongoing fee arrangements between advisors and clients unless the arrangements are renewed annually by the client. It will impose requirements of annually renewed service agreements. Implemented properly, it could provide fertile ground for innovative, tech-driven solutions that make the consumer experience easier more informed and less costly for providers to offer. How providers seek the consent of consumers when transacting with them will also be changed. Exactly how they might ascertain "informed consent" as required by the Royal Commission's recommendations remains unclear.

Consequently, how traditional operating systems can best operationalise these changes in a low-cost manner is an area where financial and regulatory technology could play a greater role than it has needed to previously. Many of these changes have been spurred from a greater desire for transparency and accountability of providers of advice and a desire for greater information and empowerment for consumers.

6.2 Digital advice

The emergence of digital or "robo" advice in Australia also present opportunities financial and regulatory technology. Digital advice (also known as robo-advice or automated advice) is the provision of automated financial product advice using algorithms and technology with or without the direct involvement of a human adviser.[23] It can comprise general or personal advice and range from advice that is narrow in scope (e.g. advice about portfolio construction) to a comprehensive financial plan.[24]

There has been some commentary, particularly from regulators as to how this product could meet growing or unmet advice need. A report released by ASIC last year showed that while

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[23] ASIC RG 255. *Providing Digital Financial Product Advice to Retail Clients*. Page 4. (https://download.asic.gov.au/media/3994496/rg255-published-30-august-2016.pdf)
[24] Ibid.

27% of Australians received financial advice, 41% of Australians intend to get financial advice in the future.[25] ASIC has marked this technology as potentially offering a low-cost alternative for those who might not engage a financial planner but are not confident enough to make these decisions themselves. The Productivity Commission has observed that 48% of Australian adults indicated having unmet financial advice needs.[26] This could indicate a potential role for digital advice in a robust financial and regulatory technology environment. An online survey of consumer perceptions about advice found that 37% of participants who recently thought about getting financial advice but had not gone ahead were open to using digital advice.[27] Public information indicates that between 20% to 40% of the Australian adult population use, or have used, a financial planner or adviser.[28]

In the future, there is need to ensure the solutions financial and regulatory technology offer to resolving growing or unmet advice need, do not involve overly complex and technical disclosures that limit access and affordability for consumers.

6.3 New parameters for product, information, and advice

Fundamental questions about what constitutes product, information and advice will come into focus as the implementation of the Royal Commission recommendations proceed. This conversation will shape tech-driven financial services delivery in Australia. Similar experiences in other markets show that digital advice has arguably blurred the lines between these areas. The European Banking Authority's (**EBA**) *Report on Automation in Financial Advice* in 2016 found that divergent definitions of 'advice' across the banking, securities and insurance sectors was one of the main barriers to automated advice.[29] Some respondents to the EBA's discussion paper also raised questions about the applicability of relevant European law and regulations to the different possible emerging business models used to offer automated advice.[30]

As the pillars of Australia's financial system are modernised in the future, an appreciation for the disruptive influence of financial technology will need to be worked into the legal framework around it.

Digital advice is an alternate stream of advice. Its impact on the advice delivery model will likely change as the Royal Commission's recommendations are implemented and the practical effects on businesses and consumers of these are felt. As a product, digital advice buffets up against the licensing regime and where it will fall within the revised definitions of

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[25] Ibid.
[26] Productivity Commission, *Draft Report: Competition in the Australian Financial System* (January 2018). Page 355 (https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft.pdf).
[27] ASIC REP 627. *Financial Advice: What Consumers Really think*. Page 5. (https://download.asic.gov.au/media/5243978/rep627-published-26-august-2019.pdf)
[28] ASIC REP 224. *Access to financial advice in Australia*. Page 14. (https://download.asic.gov.au/media/1343546/rep224.pdf).
[29] European Banking Authority. *Report on Automation in Financial Advice* (2016). https://esas-joint-committee.europa.eu/Publications/Reports/EBA%20BS%202016%20422%20(JC%20SC%20CPFI%20Final%20Report%20on%20automated%20advice%20tools).pdf
[30] Ibid.

product, information and advice is an area for policymakers and regulators to be alert to. A transaction that takes place between a client and an advisor in person, is different from a transaction via a platform between two such parties. Exploration of product and advice and discussion on how this impacts personal and general advice in the context of fintech could be a useful addition to this discussion.

Beyond these definitional considerations will be the need to ensure policy and regulation does not overlap and therefore impede an innovative advice sector.

6.4 Approach

Securing a low-cost and innovative advice industry that meets the expectations of consumers in need of affordable and accessible advice requires time. Under-developed policy solutions with ambitious timeframes ultimately pose risks to consumers and undermine trust in financial services. Pin pointing the precise conflicts between policy and regulation impeding innovation will require a deeper review.

Ensuring quality advice that is affordable and accessible to Australian consumers is the core priority of the FSC and its members. This can be achieved through policy, legal and industry-led developments that are harmonised with a robust regulatory regime for financial and regulatory technology, world-leading in its empowerment of consumers and innovative capacity to solve problems.

7 Appendix

7.1 Other adverse impacts of legacy products

At an economy wide level, the trapping of consumers in these products:

- adds to product proliferation – this undesirable proliferation is not by consumer choice.
- increases financial system risks.
- reduces competition in financial services, as consumers trapped in legacy products cannot move to competing products.
- reduces scale economies, increasing industry costs.
- reduces the productivity of financial services, dragging down economy-wide productivity.
- reduces savings and wealth.
- increases Government spending on income support, particularly the Age Pension, because of reduced retirement savings.
- reduces tax revenue because lower income/investment returns reduce income tax revenue.

The final two points imply that the lack of a product modernisation scheme is likely to have fiscal implications. While it may appear that a product modernisation scheme would cost the Government money in the short term, in the longer term a modernisation scheme may be a net benefit to the Budget as it will boost tax revenue and reduce Age Pension spending.

We also note that legacy products are more likely to pay commissions until the legislative ending of commissions. A product modernisation scheme would move consumers into products that generally are highly unlikely to pay commissions. The ending of commissions by product modernisation will reduce fees and improve net returns.[31] In addition, this would avoid the issues that may occur with the legislative ending of grandfathered commissions, including the complexity of redirecting commissions to consumers and the possibility of a legal challenge to the legislation as reported in the media.

7.2 Reviews that have called for product rationalisation

As mentioned in Section 4.5, product rationalisation has been affirmed in a number of parliamentary reports, government background papers and public inquiries:

The Super System Review **(the Cooper Review)** argued in June 2010:[32]

> *The consolidation and rationalisation of legacy products can provide benefits to members, including:*
>
> - *better product disclosure and clearer reporting to members;*
> - *lower costs — as cost savings will be passed on to members;*
> - *enhanced and newer features, for example, BPay, internet/online transactions, investment choice, unbundled offerings, more transparent and easier to understand products; and*
> - *improved service standards through better administration, greater flexibility, fewer systems and processes.*
>
> *Such benefits result principally from greater economies of scale and transfers to more modern and flexible products and systems.*

ASIC made the following submission to the interim report of the Financial System Inquiry **(FSI)** in August 2014:[33]

> *ASIC supports renewed consideration of the 2009 proposals on product rationalisation of legacy products by Government.*
>
> *…*
>
> *We support an approach developed from the 2009 proposals that provides a streamlined process for product rationalisation involving adequate disclosure and safeguards, without requirements of individual holder assent.*

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[31] This is discussed in more detail in the FSC's submission on the Draft Regulations for Ending Grandfathered Conflicted Remuneration for Financial Advisers, available from: https://fsc.org.au/resources/1756-fsc-submission-ending-grandfathered-conflicted-remuneration-for-financial-advisers-13th-may-2019/file

[32] See: https://treasury.gov.au/review/super-system-review

[33] See: https://download.asic.gov.au/media/2613736/asic-submission-to-the-financial-system-inquiry-interim-report-published-26-august-2014.pdf

ASIC report 466 *ASIC's work to reduce red tape* stated in January 2016:[34]

> ***Legacy product rationalisation***
>
> *Submissions suggested that a process be developed to rationalise legacy products. We agree that this would enable more efficient and up-to-date financial products and services to be provided to consumers, and avoid ongoing operational risk and cost associated with maintaining legacy products and systems. We have suggested implementing a process for legacy product rationalisation that balances the interests of consumers and product and service providers.*

An APRA submission to an Inquiry by the Senate Economics Committee into the *Scrutiny of Financial Advice – Life Insurance* of April 2016 stated:[35]

> *One area of potential change identified by APRA relevant to this Inquiry is the introduction of a mechanism to allow the rationalisation of legacy products to occur more easily*
>
> *…*
>
> *Over time, legacy products become more complex and expensive to administer and may no longer meet the requirements of the beneficiaries.*
>
> *…*
>
> *There is a range of very complex legal, consumer and tax issues that arise if a life insurer seeks to move policyholders from a legacy product to a new product, restricting the ability of insurers to close legacy products. The benefits of a simpler, though still robust, mechanism to rationalise legacy financial products has been recognised for some time.*
>
> *…*
>
> *APRA continues to strongly support the need to comprehensively address this issue. From the perspective of the product provider, it would help mitigate the increasing operational risk that such products create, as well as improve the industry's operational efficiency. From the consumer perspective, it has the potential to improving consumer outcomes by updating definitions, improving efficiency and administration, and lowering costs.*

[34] See: https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-466-asic-s-work-to-reduce-red-tape/
[35] See: https://www.aph.gov.au/DocumentStore.ashx?id=790eec66-f56a-4f2f-96d3-8eb6a8f65114&subId=412976

The final report of an Inquiry by the Parliamentary Joint Committee on Corporations and Financial Services into the Life Insurance Industry stated the following in March 2018:[36]

Recommendation 10.13

The committee recommends that the Australian Government introduce legislation to facilitate the rationalisation of legacy products

The Productivity Commission inquiry into superannuation said the following in 2018:

[APRA should] undertake a systematic assessment of the costs to funds of the thousands of legacy products in the superannuation system. If the evidence demonstrates that they represent a significant cost in accumulation, APRA should further refine trustees' obligations for member transfers so these products can be rationalised.[37]

The Treasury stated the following in a background paper on the life insurance industry, written for the Royal Commission into Financial Services in August 2018:[38]

The products that the life insurance industry offers are continually revised and updated. Products are often deemed uneconomic or dated as a result of changes in market structure, government policy or legislation. These legacy products increase costs to insurers, which may be passed on to consumers. They may also increase operational risks in the management of products, which can lead to administrative errors that affect consumers. In rationalising these outdated products consumers and the industry can benefit from new, more efficient products.

There are challenges to achieving this rationalisation of legacy products fairly and effectively. For example, a capital gains taxation (CGT) taxing point may arise if life company assets are transferred to another life company or a custodial arrangement as part of the rationalisation.

As early as 2006, the Productivity Commission recommended product rationalisation in its report 'Rethinking Regulation' stating

"The Taskforce considers that implementing a simplified product rationalisation mechanism that could be applied to the full spectrum of financial products would significantly improve operational efficiency and reduce the operational risks carried by financial entities."[39]

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[36] See: https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/LifeInsurance/Report

[37] Recommendation 23.

[38] See: https://financialservices.royalcommission.gov.au/publications/Documents/reforms-to-general-and-life-insurance-background-paper-27.PDF

[39] Rethinking Regulation: Report on the Taskforce on Reducing the Regulatory Burden on Business (January 2006) See: https://www.pc.gov.au/research/supporting/regulation-taskforce/report/regulation-taskforce2.pdf

Despite these observations, no noticeable progress has been made on a regime for product modernisation.