

InterPrac Financial Planning Compliance Update

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A WORD FROM MICHAEL BUTLER

ASIC and the Best Interest Duty test
Risk Insurance and Best Interest
Best Interest and Replacement Products
Continuing Professional Education
Trends noted from File Audits

ASIC and the Best Interest Duty test

*“Being a Financial Adviser isn’t as dangerous as selling
Christian artefacts at an ISIS rave party, however”*

The recent Federal Court decision in the National Sterling Group case that imposed a \$1m fine plus other penalties on the licensee for its breaches of best interest sets a large precedent. The following link contains the ASIC release.

<http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-365mr-financial-advice-firm-to-pay-1-million-penalty-for-breach-of-best-interests-duty/>

The catch 22 here is that in ASIC’s view by failing to demonstrate Best Interests the advice is then rendered to be automatically not appropriate.

Of more relevance to InterPrac advisers is the increasing number of banning’s being handed down by ASIC who have set themselves up as the arbiter of “Best Interests Duty”. We have seen a number of advisers who have been in the industry for many years, that have received no complaints from clients and then receive EU’s and Bans for in ASIC’s eyes, failing to demonstrate meeting Best Interests Duty.

It is important to understand that to meet the Best Interests Duty it not only requires advice to be in the clients best interests, the file and the SoA must demonstrate how that test has been met and it is usually the lack of documentation that is the cause of ASIC action.

We have recently released our updated SoA template which features the requirements to establish and document Best Interests and whilst we have traditionally allowed latitude in the format of SoA’s, we as the licensee are under a lot more scrutiny to ensure that any deviations from the template reflect the same demonstration of Best Interest as found in the template.

As the majority of the Best Interests Duty stems from the Scope of the Advice and Financial Objectives we have produced a guide that is used in the PreVet process and is attached to this email.

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What was perhaps acceptable as a demonstration of Best Interest 18-24 months ago has been redefined by the regulator and this has required InterPrac to be more prescriptive on our vetting arrangements – please don't shoot the messenger, it is for everyone's benefit. We are fortunate to have Shane Miller as part of the Compliance team in this regard as he has spent 2 years working within the large Institutions advice remediation projects and has first-hand knowledge of what ASIC are setting as standards within those institutions.

Risk Insurance and Best Interest

In the past Risk Insurance advice has been often treated differently when it came to "Reasonable Basis" and "Best Interests" tests as with the chronic underinsurance in Australia simply having Insurance was deemed in the clients interest as compared to having no Insurance.

Today when reviewing Best Interests ASIC are looking at the demonstration of how the amounts of Insurance, the types of Insurance (Death, TPD, Trauma and IP) as well as the operating conditions such as inside Super or stand-alone and stepped versus level are all recommended in line with the Clients objectives and needs.

This means that simply arriving at an arbitrary amount or including that the client "wanted \$1m" or even that the client wanted to replace the existing amount with a cheaper premium does not on its own demonstrate Best Interests.

The Risk Financial Needs analysis needs to be completed or an explanation of how the amounts have been arrived at included as well as any potential negative outcomes e.g when the amount of death cover or TPD is set at the level of debts, it is necessary to explain that whilst the amount s will be sufficient at the present to repay debt it may still disadvantage either the beneficiary for Death Cover or the Insured for TPD as the asset secured by the borrowings may still need to be sold to fund the on-going lifestyle.

Best Interest and Replacement Products

The requirements of 947D Product Replacement have a greater significance under Best Interest and require the adviser to demonstrate:

- Firstly, why the existing product/policy/platform or structure is no longer suitable.
- Then, what is the cost of the recommended product, as compared on an apples for apples basis. i.e. if increasing insured amounts what would be the cost of the increased amount (if available) under the existing policy.
- Then, what are the benefits gained and lost as a comparison between the 2 products; and
- Finally how the replacement of the product provides a significant benefit to the client. ASIC do not provide guidance on what constitutes significance however savings on a product must be able to be demonstrated against the cost of acquiring that product. i.e. an overall MER savings of \$250 p.a. is not a significant saving if the cost to obtain that saving comes with an exit fee of \$500 and other establishment costs of \$2000.

It is important that cost is not seen as the sole basis for Best Interests as it may be that a particular investment or policy is not available under the existing arrangements and that to meet the clients goals it is necessary to replace the existing product – the SoA must show that Goal and Need being met through both the Scope of Advice/Financial Goals and the replacement product explanations.

Action required:

Please ensure that the new template is being used or if using a variant that it has been approved by compliance. (Xplan, Midwinter and the soon to be launched Adviser Logic InterPrac templates are all approved).

If it has been some time since you have had a review consider sending a copy of an SoA to Compliance together with the Fact Find and Risk Profile/File Notes and request that it be looked at in regard to Best Interests.

Pay particular attention to Risk recommendations that the amounts and policies recommended have a basis for Best Interests

Continuing Professional Education

Advisers are reminded of the need to maintain 30 hours CPE for Financial Planning and 20 hours for Taxpayers Practitioner Board training (Financial Planning CPE that includes a taxation element is suitable for both). InterPrac will adjust the individual advisers Kaplan Records for training such as the conference and any structured CPE conducted by InterPrac, however advisers need to ensure that any training conducted outside of InterPrac has the relevant certificates sent to CPD@interprac.com.au for approval and uploading.

Trends noted from File Audits by Shane Miller

1. Some advisers remain unaware of the new Statement of Advice templates that are on the Adviser Resource Centre. These are accompanied by updated Strategic and Appendix texts.
2. Many advisers, still seemingly in the pre-Best Interests (ie. reasonable basis) environment, do not represent the Client's wants/needs using a close 'echo' of the client's wording. Instead, the need seemingly morphs in expectation of the Advice to follow.
For example: "I'm really worried about providing for my family when I die." might present in the SoA as "You wanted an insurance review." In many cases, the client's wording is lost even at the FactFind.

To appear professional, advisers seem to feel they must avoid verbatim wording, bad grammar and/or inappropriate language in the SoA. OK.

But the phrasing that you use should still reflect the sophistication of the client and not presume a 'solution'.
"You wanted a reversionary account based pension paying (\$350 pm) pre-tax invested in ETFs."

3. Advisers have said to me ... 'my clients hardly say anything and extracting goals/objectives is unrealistic.'

Certainly don't contrive to say what wasn't said.

However:

- there's a responsibility to try to extract goals/objectives

- failing that, you might comment

" You came to see me for a routine review. You had no particular concerns or issues. In our discussion, I raised the issue of"

" You wanted to understand what a financial planner could do for you. We discussed ... and you said to me that you would be interested to have an insurance Needs Analysis prepared."

4. Mixtures of electronic and hard copy data can make a reliable retrieval/identification of all relevant 'file' information very difficult for anyone other than experience administration staff. This problem is sometimes exacerbated given different accounting/financial planning data repositories. It can complicate the audit process and obscure what was said and done for the client.

Appropriate Directory and file-naming helps electronic navigation and third-party software repositories (eg. AdviserLogic) can capture a wide variety of exhibits that that have been generated by other applications and used in the preparation of financial planning Advice.

5. Insurance lump sum amounts, when determined, rely upon assumptions which are not always reproduced in the Advice. It is important to at least footnote these key assumptions to avoid a perception that insured amounts are arbitrary or inflated.

6. Fixed fees don't need to be disclosed in both \$ & % terms; variable fees (based upon the amounts invested) do need to be so disclosed.

Sometimes, the underlying nature of a fee may be easy to pick (eg. Plan Fee \$1,250; Ongoing insurance commission). However sometimes it may be ambiguous and it is wise to footnote when this is the case. eg. Ongoing service \$200 pm1 ; (footnote) 1. Fixed fee

7. When an Adviser changes his/her office location (say), the 2nd part of the FSG needs to be updated. This represents a new minor versioning eg. v8.0 becomes v8.1
When a client next time wants advice, the newest FSG version must be provided.

8. Registers ... the compliance manual lists them all and they all need to be maintained periodically. Such maintenance cannot be evidenced if they remain blank from year to year. Better to write/update, every six or 12 months, "Nil < matters > for the period < date > to < date >". Electronic registers are fine and many 'time stamp' your updates even if it's not obvious.

9. RoAs are often mishandled. Their legitimacy assumes that a previous SoA exists and the date of that SoA is recorded on the RoA. Moreover, the subject matter of the ROA must not be significantly different from the SoA.

OK usage ... the previous SoA established a portfolio 8 months ago; the RoA recommends a product switch.

Not OK ... the SOA solely recommended the establishment of a SMSF; the RoA six months later recommends the commencement of a pension in that SMSF.

Many things can influence the risk of relying upon a ROA. For example, the SoA was written 6 years earlier and the RoA says "... your circumstances haven't changed".

If you are unsure when to rely upon a RoA, please speak with the compliance team.