Dissenting Report by Coalition members of the Committee

Coalition members of the Committee recognise that the financial services and advice industry provides an important service, helping Australians with their financial health and wellbeing.

Financial advisers help Australians better manage financial risks and maximise financial opportunities. In doing so financial services providers deal with other people's money, which is why it is important to have an appropriately robust regulatory framework in place balancing the need for effective consumer protection with the need to ensure access to high quality financial services and advice remains available, accessible and affordable.

Subjected to the stress testing of the global financial crisis the Australian financial services industry performed well overall. There is no doubt that Australia's financial services reforms legislated in 2001 provided a solid regulatory foundation for our financial services industry.

There is always room for improvement. However, in pursuing regulatory change the Parliament must focus on making things better not just more complex and more costly for everyone. The Parliament must avoid regulatory overreach where increased red tape increases costs for both business and consumers for little or no additional consumer protection benefit.

In the wake of the global financial crisis there were a number of high profile collapses of financial services providers across Australia, such as the collapses of Storm Financial, Trio and Westpoint.

Following on from those collapses it was important for policy makers to assess what went wrong and what could be done better in the future to prevent – or at least minimise the risk of – such collapses occurring in the future.

This is why in February 2009, the Parliament asked the Parliamentary Joint Committee on Corporations and Financial Services to conduct a comprehensive inquiry into Australian financial products and services.

That inquiry colloquially referred to as the Ripoll inquiry reported back in November 2009 and made a number of well considered and reasonable reform recommendations.

The centrepiece of the Ripoll Inquiry’s report was the recommendation to introduce a fiduciary duty for financial advisers requiring them to place their clients’ interests ahead of their own.

The report's recommendations provided a blueprint the government could have adopted with bipartisan support, to make important improvements to our financial services regulatory framework to further enhance Australia's already first class regulation of the financial services industry.

One of the key observations of the Ripoll Inquiry in 2009, which Coalition Committee members continue to support was that[1]:

> The committee is of the general view that situations where investors lose their entire savings because of poor financial advice are more often a problem of enforcing existing regulations, rather than being due to regulatory inadequacy. Where financial advisers are operating outside regulatory parameters, the consequences of those actions should not necessarily be attributed to the content of the regulations.

Instead of implementing the very sensible and widely supported recommendations made by the Ripoll Inquiry, the government allowed its Future of Financial Advice reform package to be hijacked by vested interests creating more than two years of unnecessary regulatory uncertainty and upheaval in our financial services industry.

The government's decision making processes around FOFA over the past two years leave much to be desired. There were constant and at times completely unexpected changes to the proposed regulatory arrangements under FOFA right up until the introduction of the current legislation. Invariably this was done without proper appreciation or assessment of the costs involved, of any unintended consequences or other implications flowing from the proposed changes to the changes.

Important financial advice reforms recommended by the Ripoll inquiry have been delayed by more than two years so the government can press ahead with a number of additional contentious changes such as its costly Industry Super Network initiated proposal to force Australians to re-sign contracts with their financial advisers on a timetable imposed by the government, not chosen by consumers – the Opt-In proposal.

It is the view of Coalition Committee members that the FOFA package of legislation in its current form is:

- Unnecessarily complex and in large parts unclear
- Expected to cause increased unemployment
- Legislating to enshrine an unlevel playing field amongst advice providers, inappropriately favouring a government friendly business model
- Likely to cost about $700 million to implement and a further $350 million per annum to comply with, according to conservative industry estimates

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1 Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and Services in Australia, page 87, paragraph 5.75: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/fps/report/c05.htm#anc3/index.htm (accessed on 28 February 2012);

Based on the evidence provided to the Committee, Coalition Committee members conclude that this will lead to increased costs and reduced choice for Australians seeking financial advice.

In pursuing regulatory changes, government must rigorously assess increasing costs and red tape for both business and consumers. It is incumbent on the government to conduct a proper regulatory impact assessment to a standard which is consistent with its own best practice regulation requirements. Coalition members of the Committee assert that such an adequate regulatory impact assessment is necessary to properly assess the impact of FOFA on businesses, consumers and the wider economy.

According to the government's own Office of Best Practice Regulation the government did not have adequate information before it to assess the impact of FOFA on business and consumers or to assess the cost/benefit of the proposed changes[2]. This is highly unsatisfactory given the complexity and costs associated with the contentious parts of the proposed FOFA changes.

Not only were the government's draft regulatory impact statements found to be inadequate by its own Office of Best Practice Regulation, it based its assessment of the impact of FOFA on jobs on a single report commissioned by the Industry Super Network (ISN).

In this context it is important to note that Industry Super Network provided the only submission to the original Ripoll Inquiry arguing in favour of Opt-In[3]. The ISN proposal for a mandatory Opt-In requirement was not accepted by that very comprehensive inquiry, with no recommendation made to implement Opt-In. The government decided to proceed with the ISN recommendation for Opt-In anyway. In the circumstances, research commissioned by ISN is hardly an objective assessment of this proposed change that can be relied on by the government or the Parliament.

Coalition Committee members recommend that the Parliament insist on a proper and adequate Regulatory Impact Statement. That is a Regulatory Impact Statement which complies with the government's own best practice regulation requirements and is

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2 Department of Finance and Deregulation, Office of Best Practice Regulation, 'Non-compliance with best practice regulation requirements—Future of Financial Advice—Treasury', http://ris.finance.gov.au/2011/08/08/non-compliance-with-best-practice-regulation-requirements-%e2%80%93-future-of-financial-advice-2011-%e2%80%93-treasury-2/ (accessed 31 January 2012) and Mr Jason McNamara, Senate Finance and Public Administration Legislation Committee, *Proof Committee Hansard*, 14 February 2012, p. 30.

3 Industry Super Network submission to the Inquiry into Financial Products and Services by the Joint Parliamentary Committee on Corporations and Financial Services, August 2009, page 18: *"ISN proposes that clients should opt-in, on an annual basis and in writing, to receive and pay for financial advice"* (Submission 380: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/fps/submissions/sublist.htm - accessed 28 February 2012);

found and certified to be adequate and compliant with those requirements by the government's own Office of Best Practice Regulation.

Coalition Committee members support sensible reforms which increase trust and confidence in Australia's financial advice and financial services industry by increasing transparency, choice and competition.

However, any reforms in this area need to strike the right balance between appropriate levels of consumer protection and ensuring the availability, accessibility and affordability of high quality financial advice.

The government has been unable to point to another example anywhere in the world where a government has sought to impose a mandatory requirement on consumers to re-sign contracts with their financial advisers on a regular basis. Coalition Committee members don't support government attempts through this legislation to make Australia world champions in financial services red tape. The FOFA red tape envisaged in this legislation will increase the costs of financial advice for millions of Australians with no or only very little commensurate consumer protection benefit. A government seeking to lead the world in imposing additional financial services red tape should at least submit those proposals to a proper cost-benefit assessment.

Further, these reforms will put at risk Australia's world class financial services industry which is one of the most respect financial services industries in the world.

Coalition Committee members do not support this legislation in its current form and urge the government to adopt the 16 sensible recommendations that would improve this legislation.

If the government is not spontaneously prepared to take these recommendations on board, we urge the Parliament to insist.

Coalition Committee members highlight the following specific concerns with the legislation and urge all Members of Parliament to carefully consider these concerns before voting on the legislation.

Impact of FOFA on the financial advice industry

The Committee received evidence from many industry participants about the very serious detrimental effects the introduction of this legislation in its current form would have on the industry and on consumers. Detrimental effects include high additional costs imposed on industry participants with resulting increased costs of advice for consumers, reduced employment levels in the financial services sector leading to reduced availability and access to affordable high quality advice, as well as a further concentration of advice providers which would lead to an undesirable reduction in competition and choice for consumers.

The Committee received evidence from the Financial Services Council that the government's proposed changes would cost the industry $700 million to implement upfront and $350 million a year thereafter.[4]

Mr Craig Meller, Managing Director of AMP Financial Services, told the committee that there could be job losses in the industry of up to 25,000 over the next few years:

> One of AMP's overriding concerns is that the bill has been rushed in its drafting and that, if enacted in its present form, it would have deleterious impacts on customers, financial advisers and the broader community. We believe there are so many problems with the bill that a rigorous stock-take is necessary and substantial additional work needs to be undertaken to get the drafting right. It needs to be recognised that the additional regulatory costs of this legislation will ultimately be borne by customers, who will pay more and not obtain the advice that they need. But the initial impact will be on financial planners, and even the explanatory memorandum to the bill forecasts a halving of planner numbers in the next few years. We believe that this could lead to job losses in the industry of up to 25,000 over that period. We also fail to see how this would improve advice access. [5]

Comments from Mr Richard Klipin, Chief Executive Officer of the Association of Financial Advisers suggests that the total job losses as a result of this legislation could exceed 30,000:

> In conclusion, FOFA, as it stands, will decimate the financial advice profession. Over 6,800 adviser jobs are at risk and over 30,000 jobs in total. This excludes the businesses they support in the communities they serve and the clients they service. A piece of legislation that inflicts this amount of damage is unacceptable. FOFA as it stands will also increase the cost of advice to consumers. This committee has already had evidence that FOFA will cost hundreds of millions of dollars to comply with—and this is just for the product providers at the big end of town. It will also decimate the provision of financial advice to clients in the bush and the regions. Advice will then become a service for the wealthy, and working families and lower- to middle-income Australians who really need advice will be priced out of the marketplace. [6]

Stakeholders argued that FOFA, if passed in its current form, would cause an undesirable restructuring of the financial advice industry, with increased concentration of players in the market and less competition:

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[4] Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 23 January 2012, p. 30.

[5] Mr Craig Meller, Managing Director, AMP Financial Services, *Proof Committee Hansard*, 23 January 2012, p. 3.

[6] Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 January 2012, p. 12.

> ...I think there is likely to be a migration of advisers to large players like AMP. So, despite the fact that we think there is some competitive advantage in the advice industry for this legislation to companies like my own, we do not believe it is in the broader interests of the financial advice industry that there should be what we think is likely, which would be a consolidation of advisers.[7]

Professional Investment Services, gave the committee examples of adjustments already occurring in the industry in anticipation of what may happen under the proposed FOFA regime, such as Count Financial:

> What did Count do? They thought, 'This is all too hard. We're now going to sell out,' and they sold out to the Commonwealth Bank. Do you expect in the long term that Count will be able to offer a great array of products—a choice of products—or do you expect that their owner would ensure that their products are represented, probably disproportionally, on their approved product list? You have to ask yourself: will that be the case?[8]
>
> ...
>
> Australia did not get to be the No. 1 financial services hub in the world and respected by everybody else because we were anticompetitive. I think this is an important aspect of FOFA. We have to make sure that, in our rush to protect the consumer, there is a balance between the objectives of being able to give the consumer appropriate protection and not reducing the competition that is out there in the marketplace.[9]

Coalition Committee members consider that the disproportionate increase in costs to the industry and consumers, the reduction in the number of financial advisers in Australia, the associated additional job losses and the further concentration of financial advice services providers will have detrimental impacts on the cost, availability and accessibility of financial advice across Australia.

FOFA Regulatory Impact Statements fail government's own process requirements

The government has failed to properly assess the impact of its Future of Financial Advice changes on businesses and consumers as required by the government's own best practice regulation requirements.

On 8 August 2011, the Office of Best Practice Regulation (OBPR) noted that an adequate RIS was prepared for only one part of the proposed FOFA changes – the

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7 Mr Craig Meller, Managing Director, AMP Financial Services, *Proof Committee Hansard*, 23 January 2012, p. 9.

8 Mr Grahame Evans, Group General 17,934Manager, Professional Investment Services, *Proof Committee Hansard*, 23 January 2012, p. 71.

9 Mr Grahame Evans, Group General Manager, Professional Investment Services, *Proof Committee Hansard*, 23 January 2012, p. 72.18,313

proposed broad ban on volume-based payments from product issuers to financial advisers. It added that while RISs were prepared for the other reforms they were not assessed as adequate for the decision-making stage. As such, the OBPR assessed those FOFA proposals as being 'non-compliant' with the Australian Government's best practice regulation requirements.[10] The government's erratic development of, and constant changes to, the FOFA reforms are partly responsible for this significant defect.

Mr Jason McNamara, the Executive Director of the OBPR, explained before a recent Senate Estimates Committee that the government's 'draft regulatory impact statements' did not have enough information about the impact on businesses and consumers and the cost benefit equation of FOFA for the government to make informed decisions:

> **Mr McNamara :** Treasury provided a number of RISs in that area. I think that there were six separate RISs in that area. But we found those RISs not yet adequate. They had not met the best practice requirements.
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> **Senator CORMANN:** …My question is: why?
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> **Mr McNamara :** In regard to those RISs, essentially the impact analysis was not at a standard that we would pass.
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> **Senator CORMANN:** You say 'the impact analysis'. Can you be a bit more specific?
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> **Mr McNamara :** The impact analysis of a regulation impact statement is generally the area of the RIS that refers to the costs and benefits associated with the policy. It is the detail—the impact on business, consumers or the government. It is that sort of analysis—'this change is meant to do particular things in the economy; it is likely to have these costs and these benefits'.
>
> **Senator CORMANN:** Are you saying that the government did not even have in front of it adequate information to assess the cost benefit of the FOFA regulation changes?
>
> **Mr McNamara :** The government did not have an adequate RIS in front of it when it made those changes. That is true.
>
> **…**
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> **Senator CORMANN:** …the government's proposal to introduce the mandatory opt-in requirement and the annual fee disclosure, are they the sorts of things that were not properly assessed?
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> **Mr McNamara:** Yes. There were six elements.
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> **Senator CORMANN:** Can you list those six elements for us please?

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10 Department of Finance and Deregulation, Office of Best Practice Regulation, 'Non-compliance with best practice regulation requirements—Future of Financial Advice—Treasury', http://ris.finance.gov.au/2011/08/08/non-compliance-with-best-practice-regulation-requirements-%e2%80%93-future-of-financial-advice-2011-%e2%80%93-treasury-2/ (accessed 31 January 2012).

> **Mr McNamara:** There was: the carve out of simple products; treatment of soft dollar benefits; access to advice; replacement of the accountant's exemption; renewal requirements on ongoing financial advice fees to retail clients; and the treatment of paid commissions on insurance products within superannuation and life insurance products outside of superannuation.
>
> **Senator CORMANN:** In all of these things the government did not have adequate information in front of it as far as the regulatory impact statement is concerned before it made—
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> …
>
> **Mr McNamara:** There is a draft RIS on those elements. Treasury had prepared RISs on those elements. From our point of view they were not yet adequate.[11]

AMP told the committee that:

> ...a full regulatory impact statement should be completed before the legislation is enacted so that the impact on customers, the community, the planners and the broader industry is fully known. This is crucial given the substantial impact on small business, the implications for financial advice and the capital expenditure required to be made by the industry in computing, training, product disclosure statements, printing, auditing and many other issues which, aggregated across the industry, we believe will amount to several hundreds of millions of dollars.[12]

Coalition Committee members consider that it is imperative for regulatory changes of this magnitude to go through the proper process. The least Australians should be able to expect is that government initiated regulatory changes of this magnitude comply with the government's own best practice regulation requirements, yet these FOFA changes do not.

The regulatory impact of FOFA includes additional costs to the industry which the Financial Services Council estimated at $700 million to implement upfront and $350 million a year to comply thereafter[13] and the significant job losses outlined above. Given the very heavy financial cost imposed on the industry by the proposed changes and the associated potential job losses, as an absolute minimum, the government must commission a proper Regulatory Impact Statement, which complies with the government's own best practice regulation requirements before pressing ahead with this flawed FOFA legislation.

If not, the Parliament should insist on a proper Regulatory Impact Statement before dealing with any of these Bills.

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11 Mr Jason McNamara, Senate Finance and Public Administration Legislation Committee, *Proof Committee Hansard*, 14 February 2012, p. 30.

12 Mr Craig Meller, Managing Director, AMP Financial Services, Proof Committee Hansard, 24 January 2012, p. 2.

13 Mr John Borgden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 23 January 2012, p. 30.

Recommendation 1

That the Parliament defer consideration of the FOFA legislation until the government has submitted a full Regulatory Impact Statement in relation to the legislation currently before the Parliament which is compliant with the requirements of the government's own Office of Best Practice Regulation.

Unrealistic Implementation Timeframe

The government has proposed that the FOFA changes come into force from 1 July 2012.

The AFA[14], the FPA[15], the Corporate Superannuation Specialist Alliance[16], the Financial Services Council[17] and ANZ Wealth[18] all argued for delaying the commencement and implementation of the FOFA reforms until at least 1 July 2013 to synchronise the change with the start of MySuper.[19]

Mr John Brogden from the Financial Services Council highlighted to the Committee the impossibility of achieving the government's proposed timeframe, especially given that none of the proposed regulations were currently available to the industry:

> **Senator CORMANN:** That was my next question. I suspect I know what the answer is going to be. Do you think that the 1 July 2012 implementation date is realistic? Do you think it would be more desirable to align the implementation date of both FOFA and My Super? If so, can you give us a bit of context around that from your point of view?
>
> **Mr Brogden:** No, it is not realistic. Yes, we would like to align them. I think originally the government's hope, understandably with its parliamentary agenda being significant, was that this legislation would go through in the second half of last year. We may have been able to wear elements of it then coming into force on 1 July 2012. It is now

14 Mr Richard Klipin, Association of Financial Advisers, *Proof Committee Hansard*, 23 January 2012, p. 18.

15 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Proof Committee Hansard*, 23 January 2012, p. 48.

16 Mr Douglas Latto, *Proof Committee Hansard*, 23 January 2012, p. 74.

17 Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 23 January 2012, p. 34.

18 Mr Paul Barrett, General Manager, ANZ Wealth, *Proof Committee Hansard*, 24 January 2012, p. 2.

19 Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011. At the time of writing, the committee was inquiring into the provisions of this bill for report by 13 March 2012. The committee is aware there are a further two tranches of the MySuper legislation, one of which was introduced into the parliament on 16 February 2012.

> inconceivable. You could advise us, but this will not go through parliament or through the House of Representatives until March, April or May.
>
> **Senator CORMANN:** Mr Brogden, have you seen any regulations yet?
>
> **Mr Brogden:** No. That is the issue. As you know, once the legislation goes through, Treasury will have to provide the regulation. If we are lucky, we will know what the law says on 30 June 2012 for an implementation one minute later.[20]

Coalition Committee members share the concerns of the industry that the current implementation timeframe of 1 July 2012 is completely unrealistic given that the proposed commencement date is less than five months away.

Coalition Committee members also consider that it would make sense to implement FOFA and MySuper simultaneously. These two major changes require significant changes to the same financial service provider IT systems. It is sympthomatic of the Government's chaotic approach to this area and its lack of understanding of practical business realities that it seeks to impose two different implementation dates involving significant and costly system changes in relatively quick succession. At least the FOFA implementation should be staggered to take into account required system changes for both FOFA and MySuper.

Recommendation 2:
That the commencement date of this legislation be timed to coincide with the commencement date of the government's proposed My Super changes, which are currently scheduled to commence on 1 July 2013. The commencement date should provide at least a 12 month period from the date of finalisation of all legislation and associated regulations to enable an orderly transition and implementation period.

Opt-in will add unnecessary additional costs and red tape

The Ripoll Inquiry, having comprehensively considered the state of Australian financial products and services back in 2009, made no recommendation to force Australians to re-sign contracts with their financial advisers on a regular basis.

The government's proposed two yearly Opt-in provisions would unnecessarily increase costs and red tape for consumers and businesses for questionable consumer protection benefit.

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[20] Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 23 January 2012, p. 35.

There is no precedent for this sort of government red tape in the context of financial services and advice relationships anywhere in the world. Despite repeated requests during the inquiry for Treasury to point to examples in other parts of the world where this sort of requirement had been successfully introduced they were unable to do so.

The AFA stated clearly that "the opt-in requirements would add an unnecessary layer of administration and costs". [21]

AMP also made their position on opt-in very clear to the Committee:

> I think AMP's position has been publicly and privately very clear. We have never seen the need for the opt-in arrangements. We believe it will not add to the quality of the advice or the quality of the relationship between the financial planner and the client, and that it is an unnecessary administrative burden.[22]

The Committee received clear evidence the existing capacity for clients to opt-out of fee arrangements at any time under current regulatory arrangements:

> Clients already have the capacity to opt-out and we do not believe that Opt-In benefits the consumer or is necessary but just adds another layer of bureaucracy to the process and unacceptable level of risk to consumers through loss of advice.[23]

The Coalition Committee members strongly opposed Labor's push to force people to re-sign contracts with their advisers on a regular basis.

With the best interest duty in place, appropriate transparency of fees charged and an ongoing capacity for clients of financial advisers to opt out of any advice relationship at any stage there is adequate consumer protection without the need to impose additional costs and red tape for both business and consumers.

The Committee also received evidence expressing concern about the negative consequences which may flow for consumers who don't opt-in within the required 30 day period – that is even though they may have intended to continue with their financial advice relationship and may even have assumed that the relationship was ongoing. Even where the lack of Opt-In is inadvertent clients are automatically deemed to have ended the financial advice relationship.

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[21] Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers Ltd., *Proof Committee Hansard*, 23 January 2012, p. 12.

[22] Mr Meller, *Proof Committee Hansard*, 23 January 2012, pp. 4–5.

[23] Professional Investment Services, *Submission 17*, p.3 & 5; see also IOOF, *Submission 19*, p. 5.

In its submission the Financial Planning Association expressed its concerns as follows:

> Unfortunately, the legislation in its current form does not provide adequate protection to financial advice clients where 'the disclosure obligation' or 'renewal notice obligation' is not satisfied by the financial planner/licensee.
>
> This is because by virtue of default the client will no longer be considered an 'advice client' if the planner does not receive the client's opt-in renewal notice within the 30 day period. This may be contrary to what the client understands and may have significant ramifications at a later date when the client attempts to seek compensation from their planner for not advising them of changes to the law and / or market movements etc that may affect their financial position / decisions.[24]

At the Committee Hearings Mr Richard Klipin, Chief Executive Officer of the AFA, expressed his concerns to the Committee that this provision could actually work against the interests of consumers, especially at times of significant market turmoil:

> …This is one of the reasons it plays against the consumer interest. Except for those who actually respond and get their opt-in notice back, the rest have effectively opted out. Our view is that a strengthened opt-out is absolutely the way to go rather than a prescriptive opt-in. But if someone opts out, then they are effectively outside the advice relationship, and when you have a meltdown like the one we saw in 2007-08 or an insurance contract where something medical is changed, if you are outside that advice relationship you are outside it, not to mention the legal ramifications of that should all this end up somewhere in court. When we talk about the vague and opaque nature, when you play that circumstance out it does not play to the consumer interest and it certainly just ties up advice practices in cost and time.[25]

The Financial Ombudsman Service also highlighted in its submission that it regularly deals with circumstances where clients have inadvertently not filled out a forms:

> FOS has also dealt with a number of disputes involving circumstances where a consumer has been sent a form for completion in order to enter, renew or revise the terms of a financial arrangement with the financial services provider and the consumer has failed to do so for reasons such as illness, long holiday or difficulty in understanding technical language.[26]

Coalition Committee members are of the view that the Opt-In requirement proposed by the government in this legislation will unnecessarily increase costs, red tape and uncertainty for both consumers and businesses and should not be passed.

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[24] Financial Planning Association of Australia Limited, Submission 62, p. 7

[25] Mr Richard Klipin, *Proof Committee Hansard*, 23 January 2012, p. 20

[26] Financial Ombudsman Service, Submission 15, p. 3

Recommendation 3
That the Opt-in arrangements contained in the Corporations Amendment (Future of Financial Advice) Bill 2011 be removed from the Bill.

Retrospective Fee Disclosure Statements – not part of the government's proposed changes until the last minute

The Ripoll Inquiry made no recommendation to introduce an additional annual fee disclosure statement over and above the current regular statements provided by financial services product providers to their clients already.

Furthermore, the Committee received strong evidence that based on the various FOFA consultation sessions it was the industry's clear understanding that the government's proposal to impose an additional annual fee disclosure statement would be prospective – that is only apply to new and not existing clients.

According to the evidence received by the Committee, after more than two years of consultations by the government on FOFA, the introduction of a retrospective annual fee disclosure statement was something that took the industry by surprise when it first appeared in this legislation when introduced into Parliament in October 2011.

Mr Dante De Gori from the Financial Planning Association expressed the shock of the industry at being confronted with these provisions at the last minute:

> **Mr De Gori:** The fee disclosure is a case in point; it was not talked about. Our position was settled with respect to the exposure draft and then that changed when we received the actual legislation; it was different. There was no consultation in the middle of that.[27]

Mr Richard Klipin, Chief Executive Officer of the AFA, told the committee that:

> Fee disclosure statements were never part of the conversation and never part of the consultation. They jumped in at the last minute and are retrospective. They are a redundant item and will just cost endless amounts of time and money and will be one of the reasons why a lot of advisers will focus on the higher value clients at the expense of low and middle income Australians.[28]

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27 Mr Dante De Gori, *Proof Committee Hansard*, 23 January 2012, p. 43. See also evidence provided by Mr Santucci, President, Boutique Financial Planning Principles Group; Ms Cargakis, General Manager, Associated Advisory Practices; and Ms Petrik, Corporate Development Manager, Professional Investment Services, *Proof Committee Hansard*, 23 January 2012, p. 69.

28 Mr Richard Klipin, *Proof Committee Hansard*, 23 January 2012, p. 16.

In relation to the retrospectivity of the proposed fee disclosure statements, AMP pointed out in its submission that the government's stated policy intention in its FOFA package released on 28 April 2011 was that the opt-in requirements, including the annual fee disclosure statements, would apply prospectively only.[29]

At the committee hearings the FSC stated clearly that the retrospectivity of the annual statements was never a matter that was discussed by Treasury in consultations, even with the peak consultation group:

> With regard to the fee disclosure statement, particularly with regard to the retrospectivity of the statement, that was never discussed in any detail with Treasury, particularly with the peak consultation group. It was never, ever alluded to until it appeared in the legislation which was tabled in parliament. Indeed, in the month just preceding the bill being tabled in parliament, the conversations with Treasury, peak consultation groups and other consultation participants was that the policy was determined and it would be prospective, and therefore no discussion was entered into.[30]

In their submission AMP also highlighted concerns expressed across the financial services industry that the majority of information that would be provided in the proposed annual disclosure statement is in fact already provided to clients. At best the provision would provide for consolidation of such information into an additional statement at considerable additional expense for little or no additional consumer benefit:

> We do not believe that the provision of an additional piece of paper to a client should be seen as the solution to the purported lack of interest by the community in dealing with financial products and services.
>
> When looking at the purpose of a fee disclosure statement, it is clear that the intention is to provide clients with an opportunity to assess whether they are receiving services from an adviser that is commensurate with the ongoing fee paid.
>
> In light of the number of disclosure documents already required to be provided to a client under existing financial services legislation, it would be more efficient to incorporate the content of this disclosure in existing documents rather than to introduce additional documentation.
>
> Introducing a mandatory obligation for all legislated documentation to contain a statement that ongoing advice fees are able to be opted out of at any time by the client would be a more efficient approach to tackling the problem Government is seeking to address.
>
> FSGs, SoAs, PDSs and periodic statements would all contain a mandatory disclosure that the client is able to notify their adviser at any point should they wish to cease an ongoing fee arrangement. On an ongoing basis, periodic statements setting out the quantum of any fees paid in relation to

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29 AMP Financial Services, Submission 43, p. 12

30 Ms Cecilia Storniolo, Senior Policy Manager, *Proof Committee Hansard*, 23 January 2012, pp 34–35.

> ongoing advice would also contain the statement that a client is able to cease making these payments at any stage.[31]

AMP also highlighted the disproportionate impact the retrospective annual fee statements would have on products it no longer offers to the public, or 'legacy' products and called on the annual fee statements to be prospective only:

> AMP, as with many older financial product providers in Australia has a number of products it no longer sells or makes available to clients. These products are typically referred to as 'legacy' products.
>
> Many of these legacy products have had sales commission built into the design of the product and clients are unable to 'opt out' of paying the commission due to this. These products were sold within a completely different regulatory regime whereby the commission represented the cost of distribution. The cost across the industry of making system changes to support the removal of commissions on such legacy products is highly cost-prohibitive, largely due to the age of the IT systems on which these products are administered.
>
> Our experience is that for every dollar we would spend on making a system change to a contemporary system, it would cost us $2.50 to make the same change to a legacy product system.
>
> For a system that is in the process of being decommissioned, by virtue of it no longer administering products from which we expect to derive new business, this is a highly inefficient and unnecessarily expensive regulatory outcome.
>
> Therefore, it is imperative that all proposed FoFA reforms uniformly apply on a prospective basis only.[32]

The Financial Services Council estimated that implementation of the fee disclosure requirements will cost approximately $54 per client prospectively (for new clients) and $98 per client retrospectively (for existing clients).[33]

Coalition Committee members consider this last-minute introduction of a retrospective requirement for additional annual fee disclosure statements without consultation with relevant parts of the industry as yet another example of the very poor and deeply flawed consultation process engaged in by the government in relation to FOFA.

The government appears to have conducted some very one sided consultation with only one section of the industry, which was not taken by surprise, while ignoring the majority of relevant stakeholders in the financial services and advice industry.

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31 AMP Financial Services, Submission 43, p.12.

32 AMP Financial Services, Submission 43, p.13.

33 Financial Services Council, *Submission 58*, p. 7; *Proof Committee Hansard*, 23 January 2012, p. 36.

Coalition Committee members consider it imperative that the government be held to account for the commitment it made during the consultation process, which was accepted in good faith by industry participants, to make any additional annual fee disclosure statements prospective only.

Given the significant additional costs involved, at the very least the Parliament should insist that this additional change made by the government to this legislation very late in the process be subject to a proper Regulatory Impact Assessment. That assessment should assess whether the increased costs to be incurred by both financial services providers and ultimately consumers are proportionate with the additional consumer protection benefit sought. It must be compliant with the government's own best practice regulation requirements to be certified by the government's Office of Best Practice Regulation.

Recommendation 4
That the annual fee disclosure statements contained in the Corporations Amendment (Future of Financial Advice) Bill 2011 be prospective only as per the government's long standing commitment and that they should not apply retrospectively to existing clients on the basis that the increased costs – ultimately borne by consumers – far outweigh the questionable additional consumer protection benefits.

Recommendation 5
That the annual fee disclosure statement requirements be amended from "detailed" prescriptive information and inflexible issue rules to "summary" information only "given" at least annually to the client.

Best Interests Duty

The Best Interests Duty is an important and central part of the FOFA changes. Coalition Committee members support the introduction of a statutory best interest duty for financial advisers into the Corporations Act. However, to avoid confusion and minimise the risk of future disputes it is important to get the drafting of the Best Interest Duty right.

It is obvious that the government has struggled to come up with an appropriate definition of the Best Interest Duty.

A version of the Best Interests Duty was included in the Exposure Draft of what became the *Corporations Amendment (Future of Financial Advice) Bill 2011* but was hastily removed from the version of the Bill that was ultimately introduced into Parliament.

The current version of the proposed Best Interest Duty included in the subsequent second FOFA Bill is certainly an improvement to the version included in the Exposure Draft.

However, as was pointed out to the Committee the duty contained in the legislation is not a true fiduciary duty as recommended by the Ripoll Inquiry. The Trust Company asserted that a best interest duty as provided for in the Bill:

> ...is not a complete fiduciary obligation but one aspect of it. A fiduciary obligation is a principle based on undivided loyalty and trust to act in good faith and in the best interests of a client. Looked at in isolation a best interest obligation is not as far reaching.[34]
>
> ...
>
> The best interest duty as expressed in the Bill is a prescriptive duty and will cause confusion and uncertainty in the industry. It is confusing a duty of care on one hand with a duty of loyalty on the other. The Bill attempts to address a duty of loyalty by using standards and rules which are associated with the duty of care. These two duties cannot be confused. It is the duty of loyalty that underpins the fiduciary obligation and it is this duty that should be met.[35]

The Joint Consumer Groups told the Committee that clause 961B may cause uncertainty and unpredictability:

> ...it may be difficult for courts and external dispute resolution schemes to interpret the duty and there is a risk that their interpretations may not further the government's policy aim.[36]

The Financial Services Council noted that new best interests obligations on advisers would add to, rather than replace, existing duties for advisers:

> ...whilst the steps in s961B(2) are largely congruent with, they are **additional** to the duty an adviser owes their client under common law fiduciary obligations (profit and conflict rules) and at contract law (and torts). As such advisers will operate under a number of, each slightly nuanced, disparate legal 'best interest' obligations which adds to the complexity and cost of the regime.[37] (emphasis added)

Many stakeholders argued against the inclusion of the 'catch-all' provision in 961B(2)(g),[38] including the Law Council of Australia:

> Although section 961B(2) provides that a provider will be deemed to comply with their statutory best interests duty if they prove that they have satisfied all of the steps in section 961B(2), section 961B(2)(g) effectively

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34 The Trust Company, *Submission 53*, p. 11.

35 The Trust Company, *Submission 53*, pp 2, 7.

36 Joint Consumer Submission, *Submission 25*, p. 11.

37 Financial Services Council, *Submission 58*, p. 42.

38 AMP Financial Services, *Submission 43*, p. 16; Mr Paul Barrett, General Manager, Advice and Distribution, ANZ Wealth, *Proof Committee Hansard*, 24 January 2012, p. 4; Associated Advisory Practices, *Supplementary Submission 20*, p. 6.

> takes away the certainty the opening words offer...In other words, a provider will comply with their statutory duty to act in the best interests of their client if they prove that they have acted in the best interest of their client. The statutory defence in section 961B(2) therefore gives providers no comfort at all that if they follow the prescribed steps they will have discharged their obligation and leaves them with the difficult task of determining what the statutory duty to act in the best interests of their client means.[39]

The Financial Services Council warned the best interests duty will push up Professional Indemnity insurance premiums for advisers:

> Without a defined duty and non-exhaustive conduct steps, Professional Indemnity ("PI") insurers will become cautious for years (whilst the new duty is tested in the courts) during which time – costs of PI cover will remain high (higher than current costs) thereby increasing the cost of advice for Australians without any commensurate consumer protection.[40]

Coalition Committee members consider that a properly drafted Best Interests Duty would enhance and improve the consumer protections afforded to clients of financial advice in Australia by enshrining the principle that financial advisers must place their clients' interests ahead of their own when providing financial advice.

However, we are concerned that the 'catch all' provision contained in section 961B(2)(g) would create uncertainty for both clients and their advisers and leave the legislation subject to potentially protracted legal arguments. We therefore recommend that this clause be removed from the Best Interests Duty.

Recommendation 6
That section 961B(2)(g) be removed from the proposed Best Interests Duty to remove uncertainty about the practical operation of the Duty.

Providing Scaled Advice

One way of ensuring that clients are able to access affordable and appropriate financial advice would be to allow advisers and their clients to limit the scope of the advice to a series of discreet areas identified by the client rather than to mandate a full financial plan in every case.

This concept of focusing advice to areas specifically identified by a client has become widely known as 'scalable advice'.

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[39] Law Council of Australia, *Submission 55*, p. 4.

[40] Financial Services Council, *Submission 58*, p. 41.

Numerous submissions to the Committee expressed concern that the wording of the best interests provisions in the proposed legislation does not allow for scaled advice to be provided.[41]

Several organisations argued that the wording in subsection 961B(2) should be amended to explicitly allow the provision of scaled advice.[42]

As stated by the FSC:

> Clear express statutory recognition of the ability to scale or scope the advice subject matter is what enables an adviser to focus their advice investigation to the area(s) the client has identified, instructed or agreed they want the advice to address and therefore curtail the cost of providing the advice...Further amendment is required to s961B(2) to expressly provide the ability to scale advice.[43]

A mere amendment to the EM to enable an adviser to have regard to the client's relevant circumstance rather than all financial circumstances will not enable scalable advice. The adviser will still not be able to limit or scale the investigation to the client's relevant circumstances to the scope of the client's instructions. Therefore the adviser will still have to investigate all the client's relevant financial circumstances. Only by enabling the client to limit the adviser's investigation in agreement with the adviser, will scalable and affordable advice be delivered by these reforms.

The availability of scalable advice and the capacity of an adviser and a client to be able to scope the advice subject matter should be clarified beyond doubt in the legislation.

Limiting the investigation is not a reduction or curtailment of the adviser's best interest duty to that client. It is important to also consider that not all prospective advice clients will want to limit or scale the advice. Indeed the adviser's over-arching duty to the client would still require the adviser to ensure that a client whose relevant circumstances requires broader advice to provide it consistent with the best interest duty, thus the client remains protected.

Coalition Committee members support and encourage the provision of scalable advice where the request for such limited or scaled advice is instigated by the client. This would allow many people to access advice more frequently and would be a very good

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41 Association of Financial Advisers Ltd, *Submission 66*, p. 12; Association of Superannuation Funds of Australia, *Supplementary Submission 1*, pp 2–4; AMP Financial Services, *Submission 43*, p. 17; Westpac Group, *Submission 64*, p. 15; Professional Investment Services, *Supplementary submission 17*, pp 5–6.

42 Financial Services Council, *Submission 58*, p. 46; Australian Bankers' Association, *Submission 67*, p. 17.

43 Financial Services Council, *Submission 68*, pp 45–46.

starting point for clients to seek financial advice for the first time without being required to undertake a costly and sometimes unnecessary complete financial plan.

We therefore recommend that the provisions of the best interest duty be amended to explicitly allow for clients and advisers to contract for such scalable advice.

Recommendation 7
That the best interests duty in the proposed legislation be amended to explicitly permit clients and advisers to agree to limit the subject matter of advice provided in order to facilitate the provision of 'scalable advice'.

The government's confused and ever-changing position on Risk Insurance inside superannuation

Coalition Committee members support the banning of conflicted remuneration structures such as product commissions within the financial services industry and commend the industry for moving proactively and effectively to abolish such conflicted remuneration structures.

However we do not consider that commissions paid on advised risk insurance, be they group policies or individual policies, inside or outside superannuation, are conflicted remuneration structures.

The Ripoll Inquiry did not make any recommendation to ban commissions paid for risk insurance products.

The government's position on this matter has been confused and ever-changing.

In April 2011 Minister Bill Shorten stated that:

> … the Government has decided to ban up-front and trailing commissions and like payments for both individual and group risk within superannuation from 1 July 2013.[44]

The Coalition did not agree with this position because we do not agree with Labor's assertion that commissions on risk insurance are in themselves a conflicted remuneration structure.

We know from recent experience in the UK that the banning of commissions on risk insurance does not work, which is why the UK has reversed that decision.

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44 Minister's Media Release, 28 April 2010, http://www.treasurer.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf .

Banning commissions on risk insurance will increase costs for consumers, remove choice and leave many people worse off – particularly small business people who self-manage their super.

We already have a problem of underinsurance in Australia, which this proposed ban would only make worse because it increases the upfront cost of taking out adequate risk insurance.
To treat commissions on all risk insurance inside super differently from insurance outside super will also create inappropriate distortions, which would not be in the best interests of consumers.

We agree that those Australians who receive automatic risk insurance within their super fund without accessing any advice should not be required to pay commissions.

However, those Australians who require and seek advice to ensure adequate risk cover, whether inside or outside of their super fund, should have the same opportunity to choose the most appropriate remuneration arrangement for them.

In August 2011 Minister Shorten seemed to adopt the Coalition's sensible position and agreed to limit any ban on commission to automatic risk insurance arrangements within super where fund members do not access any advice.

However, many submissions made to the Committee expressed concern that the government's proposals as contained in the legislation before the Committee would not achieve the stated aims and may lead to unintended consequences.

Much of the industry concern centres on the government's decision to ban commissions on risk insurance advice considered to be 'group risk' which catches not only the default option automatic insurance provided in a superannuation fund with no advice provided, but would also extend to any advised risk insurance that is selected and purchased by a fund member after receiving specific and tailored individual advice if that risk insurance was covered by the 'group' policy held by the fund.

These concerns were encapsulated by this statement from IOOF Holdings:

> A vast majority of the population settle for the default insurance cover provided within their default super fund and are, consequently, under-insured. Those that do seek advice obtain appropriate levels of cover most typically through group life insurance arrangements. The ability to pay commissions from inside super rather than having to pay from after-tax salary is a primary reason for those who do accept to be advised on risk insurance. The removal of risk insurance commissions inside super will exacerbate the existing under insurance situation in Australia.
>
> Fee for service with adviser-driven insurance presents practical challenges. Imagine a situation where an adviser must do significant work, and so

> charge the client at the time a claim is lodged following the death or injury of the client's partner.[45]

The AFA argued against a ban on insurance commissions:

> The arguments for a ban on commissions on insurance have not been anywhere near sufficient to gain broad support. In fact there are many strong arguments for why commission should continue on risk insurance products. Many of these arguments were covered in the Ripoll Inquiry. The key difference between Investments/Superannuation and Risk is that commission free investment and superannuation products already exist, and have in fact been readily available for clients with larger investable amounts for a number of years. Risk Insurance is a very different product set (similar in many ways to general insurance type products), has an annual renewal period, and a defined benefit or risk addressed. Thus the AFA has argued that risk should remain outside the FoFA remuneration changes. The Government took a similar position in their April 2010 announcement... The AFA recommends that this area be the subject of greater research and investigation. In the context of corporate superannuation and group life insurance, there needs to be a comprehensive review of the current model across retail, corporate and industry fund superannuation plans. Consideration needs to be given to a sensible alternative remuneration model for insurance arrangements, where advice is provided.[46]

IOOF Holdings argued that the Bill creates distortions between advice that is provided inside and outside superannuation:

> We submit that it is inequitable to permit charging of commissions on individual life risk policies within super while disallowing it for group life risk policies, even though the clients in both instances have obtained advice in relation to their insurance requirements. Equally it is inequitable between clients within the superannuation and non superannuation environments where a financial adviser is managing clients' investments holistically. We would further submit that it should be acceptable for level commission to be payable to financial advisers on group life policies as this in fact eliminates perceived conflicts.[47]

The AFA was also concerned:

> ...we are facing a world where there are two different playing fields. If you are an individual, you can get advice and the adviser can get paid a commission inside and outside super. You can do the same for large group plans outside super, but not inside super. So what you end up with is a playing field that really has different rules and, in our view, will distort the advice outcomes as consumers look for the best outcome and obviously work with the advisers that look after them. The simple way to think about

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45 IOOF Holdings Limited, *Submission 19*, p. 4.

46 Association of Financial Advisers, *Submission 66*, p. 11.

47 IOOF Holdings Limited, *Submission 19*, p. 4.

> it is to take the view that, where advice is provided, commissions are allowable whether they are inside super or outside super; where no advice is provided, clearly there should not be any payment. But to create an artificial piece around the way advice is provided makes no sense at all. In fact, for those advisers who are specialists in the small business superannuation environment, it is a significant threat to their future and to their business.[48]

Pauline Vamos from the Association of Superannuation Funds of Australia (ASFA) also expressed concerns about the approach taken by the government

> **Ms Vamos:** There are two points I would like to make. The first is that wherever you have regulatory arbitrage it will drive behaviours.
>
> **Senator CORMANN:** It will create distortions.
>
> **Ms Vamos:** While ever you have distortion you will drive certain behaviours. What those behaviours are I do not think we can foresee but certainly any regulatory arbitrage is, I think, always something to be avoided in any legislation and in any policy. In terms of the ban on individual commissions within superannuation, the issue that has been raised with us—
>
> **Senator CORMANN:** Are you talking about risk insurance?
>
> **Ms Vamos:** Risk insurance within super. The issue that has been raised with us is this: the government's policy is very much when you receive individual advice about your individual cover and it is a stand-alone cover, so you are not part of an employer group, then commission should be able to be paid because you have got an engaged managed relationship with that adviser. Because of the nature of superannuation funds and because of the nature of the trust structure, the trustee buys the wholesale group policy. Where you have individual persons who are not part of employers but who are individuals putting their insurance under the fund because of tax purposes or efficiency purposes, they have individual cover, individual advice and are individually remunerated to the adviser. But because it is under a wholesale group policy they are still caught.[49]

Coalition Committee members believe that where possible such opportunities for regulatory arbitrage should be avoided. We also believe that where individuals seek specific advice on appropriate risk insurance the remuneration structure for such advice should be neutral so that it does not distort the advice provided. This should be the case whether the advice provided is within or outside superannuation or whether the cover purchased is a stand-alone policy or within a wholesale group policy.

In fact, to make it harder and costlier to obtain risk insurance through a wholesale group policy would lead to Australians paying more for risk insurance and may

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48 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 13.

49 *Committee Hansard*, 24 January 2012, p. 13.

exacerbate the existing problem of underinsurance. This is a poor outcome of this policy and proposed legislation.

Considering the Government's proposed MySuper reforms will see all prospective superannuation guarantee contributions made to a MySuper account from 1 July 2013, requiring these legislative changes with a high probability of impacting Australian's insurance levels and increasing the cost of insurance is irresponsible of Government. The Government's consumer protection mechanism rests in the MySuper reforms and should therefore refrain from these significant unjustifiable reforms.

Recommendation 8
That no changes to existing remuneration structures be made where risk insurance is purchased by an individual consumer who has received specific advice on such insurance, whether such risk insurance is purchased inside or outside superannuation or whether such risk insurance is purchased through an individual policy or through access to a wholesale group policy.

Recommendation 9
That any ban of commissions on risk insurance in superannuation be limited to automatic insurance cover within superannuation funds where individuals have not accessed any specific advice, namely in default superannuation arrangements.

Conflicted remuneration

As stated above, Coalition Committee members support the elimination of conflicted remuneration structures in the financial services industry and commend the significant moves taken by the industry to eliminate such structures, particularly by moving to a fee-for-service model and reducing the reliance on product commissions.

However, we are concerned at the significant concerns highlighted by the industry to the Committee that the proposed changes in the legislation were too broad, created unintended consequences and prevented some legitimate payments that were not conflicted remuneration.

The concerns about conflicted remuneration fall into three broad categories as follows:

1. Monetary conflicted remuneration;
2. Non monetary conflicted remuneration; and
3. Other banned remuneration such as shelf space fees.

Monetary conflicted remuneration

The Law Council of Australia is concerned that the definition of conflicted remuneration is too broad and is not limited to personal advice:

> Any fee or charge may be conflicted remuneration under the general definition in section 963(1) if the licensee or its representative provides financial product advice to a retail client which could have the necessary influence. For example, a product issuer who provides general financial product advice (for example in the form of a product disclosure statement), could be prohibited by the ban on conflicted remuneration from receiving a management fee as the fee could be interpreted as being capable of influencing its general advice to investors. It could also prevent trustees of superannuation funds paying fees based on assets under administration or the number of members to fund administrators (who also provide general or personal advice to members).[50]

ABA and FSC argued that remuneration relating to general advice should be exempted from the ban, as general advice is:

> a) Given in a far wider range of circumstances than personal advice and is therefore likely to apply to a far wider range of situations than is necessary or intended;
>
> b) Far less influential on the decision of a retail client than personal advice; and
>
> c) Not the context in which the issues and concerns referred to in the Explanatory Memorandum arise'.[51]

AMP expressed concerns that the sale of a financial planning business between a licensee and its authorised representatives may be caught up in the provisions of section 963B and be considered conflicted remuneration simply because the nature of the business involves conflicted remuneration. [52]

The Financial Services Council pointed out that in many cases it would be administratively impossible to comply with the provisions of s963B(1)(c) which offers an exemption. They explained the conundrum presented by the drafting of this clause:

> The execution only exception contained in s963B(1)(c) will not apply if the licensee or representative has previously provided advice to the client. There is no causal link and no time limitation as part of this clause. Because of this, it will not be administratively possible to ensure compliance with this provision.
>
> For example:
>
> (a) *(Marketing campaign)* A general marketing campaign in the past conducted by the licensee that contained general advice relating to superannuation products. This would mean that any authorised representative of the licensee will not be able

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50 Law Council of Australia, *Submission 5*, p. 9.

51 Financial Services Council, *Submission 58*, p. 76.

52 AMP Financial Services, *Submission 43*, p. 24; See also Financial Services Council, *Submission 58*, p. 79.

> to rely on this exemption for execution only services in relation to superannuation products.
>
> (b) *(Previous advice)* An employed financial adviser may have provided advice in relation to managed investment schemes as part of a financial plan five years ago to the client. This will mean that any execution only services in relation to managed investment schemes provided by an adviser (of the same licensee) now will not fall within the execution only exemption.

This concern was also strongly expressed by Westpac in its submission to the Committee.[53]

Coalition Committee members have made a series of sensible recommendations to address these specific concerns whilst preserving the spirit and intention of the ban on monetary conflicted remuneration.

Recommendation 10

In relation to monetary conflicted remuneration that:

(i) 'General advice' should be specifically exempt from the definition of 'conflicted remuneration';

(ii) That the proceeds of the sale of a financial planning business between a licensee and its authorised representatives should be specifically exempt from the ban on conflicted remuneration; and

(iii) That section 963B(1)(c) be amended to link the payment for advice provided to a specific advice provider (rather than to any representative of a licensee) and to apply only where there is a causal link between past advice and current advice.

Non monetary conflicted remuneration

In submissions to the Committee the financial services industry also highlighted concerns that the legislative bans on non monetary conflicted remuneration were confusing and in some cases the legislation itself did not accurately reflect the stated policy intention contained in the Explanatory Memorandum.

The Financial Services Council explained this anomaly in its submission to the Committee:

> Paragraph 2.39 of the Explanatory Memorandum ("EM") states that:
>
> "The ban on non-monetary benefits is also not generally intended to cover the services provided by a licensee to its authorised representatives for the purposes of the authorised representative providing financial services on behalf of the licensee. These services would only be captured by the ban if the services were provided in such circumstances where it might conflict financial product advice."
>
> This statement confirms the intention of the Government to permit licensees to provide nonmonetary benefits to authorised representatives for the

[53] The Westpac Group, Submission 64, p. 22.

> purposes of those authorised representatives providing financial services. Some of the drafting for the exclusions to the overall ban on non-monetary benefits does not fully reflect the intention expressed in paragraph 2.39 of the EM.
>
> Further, s963C as drafted captures benefits provided by an employer to their employee (Licensee to their representative). We believe this is unintentional and recommend these provisions be amended to include benefits from Licensee to an authorised representative and or their representative.[54]

The legislation imposes a $300 limit on the value of certain non monetary benefits. In its submission to the Committee the Financial Services Council states that in all consultation about this provision it was made clear by Treasury that this limit would apply separately to a licensee and to each representative rather than on an aggregate basis for each licensee.

However, the submission points out that the Explanatory Memorandum for the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*does not clearly reflect this intention and may be interpreted to imply that the $300 limit may apply as an aggregate figure.[55] Coalition Committee members recommend that this uncertainty should be clarified by amendment to the Explanatory Memorandum.

The legislation allows an exemption from the $300 limit for certain types of training and education. However, it imposes a geographical limit on where the training can be conducted restricting training to Australia and New Zealand only. The legislation also restricts training to that which is 'relevant to the provision of financial advice'.

AMP pointed out the negative impact and limitation of opportunities that a geographical restriction on the location of training would have for Australian financial planners:

> To limit the location to Australia or New Zealand would imply that conferences in other jurisdictions would not be genuine professional development. For example, the Financial Planning Association in the United States of America (USA) has a regular conference which can be extremely beneficial for advisers to attend. Industry insights, the opportunity to learn from others and to understand industry trends can be obtained from attending such a conference. For Australia to be a financial services hub, it needs to effectively compete with other jurisdictions. To limit professional development to only Australia and New Zealand unnecessarily limits our opportunities as an industry.[56]

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54 Financial Services Council, *Submission 58*, p. 81.

55 Financial Services Council, *Submission 58*, p. 81 – 82.

56 AMP Financial Services, *Submission 43*, p. 23.

The Financial Services Council highlighted that to restrict training to that which is deemed 'relevant to the provision of financial advice' would prohibit provision of other very relevant and important training:

> Specifically, what is meant by the term "relevant to the provision of financial advice"? Financial advisers are engaged in a range of activities which extend beyond giving advice. Not only do they engage in dealing activities such as arranging for investments to be made and for trades to be placed, they also undertake administrative activities for clients. Furthermore, there is a range of training that may be relevant to the business of a financial adviser but which would not be obviously 'relevant to the provision of financial advice' such as training relating to equal opportunity, occupational health and safety training, running a (small) business and marketing. Nor would it permit the development of soft skills like client servicing/client relationship training which we understand from discussions from ASIC pre the issue of Consultation Paper 153, are areas ASIC is interested in seeing advisers improve. Courses on these types of topics are clearly for a genuine education or training purpose but could be prohibited by s963B(c)(ii). We are concerned that by requiring the training to be "relevant to the provision of financial advice" uncertainty may arise regarding the range of topics that can be covered at a conference.[57]

The Financial Services Council also highlighted an anomaly caused by the wording of subsection 963C(d)(ii):

> The use of the expression "financial products issued or sold by the benefit provider" in subparagraph (d)(ii) unnecessarily limits the exemption to product issuers and does not include the licensee of a financial planner unless they also happen to issue products.
>
> Licensees who provide financial planning often do not issue products or "sell" them. The most common scenario is for these licensees to be authorised to advise on, and arrange for a client to deal in financial products. We are also concerned for the reasons noted above that the benefit should not be limited to "the provision of financial product advice". The problem is even more acute in relation to this exception as any software or IT support is likely to relate to systems to facilitate advisers to access the issuer's product and to arrange for it to be issued to their client or to implement changes to product options. These activities are either dealing or administrative and are not in that sense "related to the provision of financial advice" which might be seen as limiting any software to research related information to enable an adviser to decide whether to recommend a product.
>
> Advice licensees should be able to provide IT support and services to their authorised representatives and representatives and ensure issuers can provide IT support and services relating to arranging for products to be issued or varied.[58]

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57 Financial Services Council, *Submission 58*, p. 82 – 83.

58 Financial Services Council, *Submission 58*, p. 84.

To address the concerns expressed to the Committee about the ban on non monetary benefits, Coalition Committee members have made a series of sensible recommendations that preserve the integrity of the conflicted remuneration provisions while providing clarity and certainty for the financial services industry as to how these provisions will apply on a practical day-to-day basis.

Recommendation 11

In relation to non monetary benefits:

(i) The legislation be amended to clearly state that non monetary benefits can be provided by a licensee to its employee authorised licensed representative or representatives;

(ii) The Explanatory Memorandum of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended to make it clear that the $300 limit should apply on a per employee basis rather than apply as a $300 aggregate across all employees;

(iii) The training exemption in the legislation should permit training which is relevant to conducting a financial services business rather than be limited only to the provision of advice.

(iv) The location of training, including conference location, should not be geographically limited to ensure that the Australian financial services industry remains world class; and

(v) Subsection 963C(d)(ii) be amended to read "the benefit is related to the provision of financial services to persons as retail clients".

Volume-based fees

The Committee received many submissions expressing strong concern about how the proposed restrictions on volume-based fees in Division 5 of the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* would operate in practice.

The government's expressed policy intentions, the divergence of Division 5 as drafted from the original policy intentions, the unintended consequences that arise from the drafting of Division 5 and the practical consequences for the industry were well summarised in the submission from the Financial Services Council:

> The Minister announced in April 2011 that "if structural reforms in the industry is to truly transpire, all conflicted remuneration, including volume rebates from platform providers to dealer groups must cease." Further the Minister was quite clear that "there will be a broad comprehensive ban, involving a prohibition of any form of payments relating to volume or sales targets from any financial services business to a dealer group, authorised representative or advisers".
>
> We are broadly supportive of the policy intent of Division 5 as described in paragraph 2.50 of the EM. However, Division 5 is not limited to payments that are paid to a dealer group, authorised representative or advisers (as previously specified by the Minister).

Instead this section is a broad principles-based ban on the payment of any benefit which is determined by volume between any licensees and operators of custodial arrangements.

This Division has the potential to adversely impact the efficient operation of the funds management industry – potentially putting it out of step with international markets and impacting Australia's ability to compete as a financial services centre.

Further, contrary to our understanding of the policy intent, this Division appears to have a number of unintended consequences, including:

(a) The proposed ban captures platforms that do not seek to influence client decisions in relation to financial products accessible through the platform;

(b) The definition of "funds manager" captures many entities who are not funds managers;

(c) The term "volume-based shelf space fee" on which the entire division hinges on is broadly defined on a presumption of any benefit determined by value which captures many types of payments that are not shelf-space fees (as commonly understood);

(d) Dollar based fees – the legislation does not exclude "flat" shelf space fees that are operational in nature as announced by the Government in April 2010;

(e) Volume rebates paid by fund managers with respect to pooled investment vehicles appear to be banned for IDPS structures, whether or not they are 'reasonable', potentially creating a distortion in the market by giving a competitive advantage to mandate structures. As previously documented in numerous FSC submissions to Treasury, bias to one investment management structure will distort the market reducing market competition and directly resulting in increased investment costs for retail clients.

(f) To the extent that a rebate or discount is banned by this section, consumers of these investments will no longer be able to benefit from the Platforms passing on these rebates or discounts (through a credit to their investment or superannuation account).

The policy announcements had stated that only volume based shelf space fees paid by a fund manager to a platform provider (and any sharing of these with licensees and/or advisers) would be banned.

The provisions are much broader due to the definitions of "funds manager" and "platform operator" being simply referenced as licensee to licensee which captures many other licensee to licensee payments. The application of the provision means that it may apply in much broader circumstances than simply for fund managers to platform providers and does not just prohibit payments for shelf space.[59]

59 Financial Services Council, *Submission 58*, p. 59 – 60.

Further, there is confusion in the varied payments and the term volume based shelf space fees. Unlike a supermarket analogy, dollar based shelf space fees are not paid for preferential placement on a menu but for the administration of the fund manager's investment option on the platform menu. The platform generally charges the same fee for each investment option on the menu. In recent years, volume based shelf space fees may have been charged by some platforms of fund managers for preferential programs. There is agreement that these volume based shelf space fees should be banned.

However, volume based rebates have been consumed in the proposed legislation under the same definition "volume shelf space fee". This is not only erroneous, but to simply ban these or make the burden of proof in receipt of these rebates so arduous is to potentially legislate preference for certain types of funds management structures over others. The end result of the bias will have profound impacts on the funds management industry and therefore on the cost of investment for many Australians – particularly via their super. To ban or make the burden of proof so complex and competitively damaging may result in zero rebates (effectively zeroing out investors investment management fee discounts). These rebates must be able to continue to flow from fund managers to platforms and super funds. No flow of rebates will be permitted to flow to advice licensees. If concern remains, the legislation could simply read that volume related payments or rebates of investment management fees are permitted from fund managers AFSLs to platform providers/super funds for the benefit of the end investor.
To address these concerns the Coalition Committee members have made a series of sensible recommendations that give effect to the government's stated policy intention and provide the industry with a practical, clear and certain pathway forward as they implement some very dramatic changes to their business models to give effect to the policy intention in relation to volume-based fees.

Recommendation 12
In relation to volume based fees that Division 5 should be amended as follows:

- **i. Section 964 should be amended to define the terms "fund manager" and "fund manager's financial products" so that the definition does not capture other providers that are not intended to be caught by this section;**
- **ii. Shelf space fee should be explicitly defined to minimize the unintended consequence of capturing entities and payments not intended to be the subject of any ban;**
- **iii. Section 964A should be amended to prohibit the paying or passing on of remuneration from a platform to a licensee or representative to clearly reflect the intention of the ban;**
- **iv. Section 964A should be amended to expressly exempt general and risk insurance from the application of Division 5.**
- **v. Flat dollar shelf space fees should be expressly carved out of Division 5.**
- **vi. That Section 964A(3)(b) be amended to delete the words "does not exceed an amount that may reasonably be attributed to efficiencies gained by the funds manager because of the number or value of financial products**

obtained by a fund manager". This will permits rebates from fund managers to product providers/platforms in line with government announcements, to ensure system neutrality and to retain consumer scale benefit discounts.

Grandfathering Provisions

Coalition Committee members consider that it is a fundamental expectation of any legislative reform that existing contractual arrangements should be recognised and grandfathered to preserve existing property rights.

The financial services industry expressed some concerns that the grandfathering provisions relating to the ban on conflicted remuneration did not achieve this aim and that the wording of the provisions would create uncertainty for many of these existing property rights, in particular payments made by platform providers to dealer groups.

The Australian Bankers' Association stated that:

> Firstly, banks and other financial service providers have varying employment and workplace arrangements as well as contracts and service agreements. In the absence of clear grandfathering arrangements, it is uncertain whether the Government is able to intervene in these arrangements, contracts and agreements legally or whether banks and other financial service providers are able to cease or alter these arrangements unilaterally or within imposed timeframes. We note that some arrangements have years to run before they expire or are due to be renegotiated...
>
> Secondly, the issue of 'crystallisation' must be taken into account during the drafting of the grandfathering provisions. This issue was noted in Minister Shorten's announcement, which indicated that the ban on conflicted remuneration would prohibit future payments to, for example, licensees/representatives in respect of new investments through a platform but will grandfather payments to licensees/representatives in respect of investments in a platform accumulated prior to 1 July 2012. This means the level of volume payments from platform providers to dealer groups will 'crystallise' and result in the need for major reconfigurations to support crystallisation of overrides, such as trail commissions, as at the commencement date.[60]

In a supplementary submission to the Committee, Professional Investment Services also pointed their concern that the inadequacy of the grandfathering provisions may raise Constitutional issues:

60 Australian Bankers Association, *Submission 67*, p. 40.

> Grandfathering of existing arrangements are allowed for commissions arrangements already in place (prior to commencement of legislation) without express statutory protection of existing platform provider payments and arrangements. This is inconsistent with the transitional arrangements and grandfathering of existing commission payments provided for in s1528 of the Bill and is also at material risk of constitutional validity challenge with s51(xxxi) of the Constitution.[61]

Professional Investment Services also articulated their specific concerns about the grandfathering provisions as follows: Following is PIS's explanation of the grandfathering issue Sub 17 supplementary page 12

> We submit that there is a significant risk that failure to grandfather benefits provided by platform providers under existing arrangements, or arrangements entered into prior to the commencement of the legislation, is contrary to the constitutional power s51(xxxi) which provides Parliament with the power to make laws with respect to the 'acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws.'
>
> The FoFA reforms proposing to ban existing contractual rights (we note that contractual rights can be property for the purposes of s51(xxxi) of the Constitution8), such as prohibiting payments received from platform providers without grandfathering provisions, may fall foul of the requirement to acquire property on 'just terms.' This is on the basis that one party is deprived of the right to receive a payment of money arising under a contract while the platform provider receives the corresponding benefit of no longer having to make such benefits.[62]

We therefore recommend that appropriate amendments be made to the grandfathering provisions to recognize and preserve existing and long standing property rights and to ensure that commission payments from platform providers are not banned retrospectively.

Recommendation 13
That sections 1528(1)(b) and 1528(2)(b) should be deleted because they retrospectively ban long-standing contractual payments from platform providers.

Anti-Avoidance Provision

The proposed new section 965 is an anti-avoidance provision designed as a catch all provision. This is a complex and far reaching provision that does not have regard for what is permitted, grandfathered or made exempt by the reforms.

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61 Professional Investment Services, Submission 17 (supplementary), p. 3.

62 Professional Investment Services, Submission 17 (supplementary), p. 12.

The Anti-Avoidance measure was introduced to Parliament on 13 October 2011 as part of the Corporations Amendment (Future of Financial Advice) Bill 2011 before the industry had an opportunity to review or assess its impact.

In its submission to the Committee the Financial Services Council expressed its concern that the scope of the provision appeared to capture existing legally binding contractual arrangements that are actually grandfathered in other parts of the legislation:

> Further, the scope of the application of section s965 is complicated by the uncertainty regarding how this provision interacts with any arrangements already entered into (or entered into prior to 1 July 2012) and with any grandfathering provisions which the Government may provide.
>
> Specifically, the wording of s965 does not exclude existing arrangements which may inadvertently capture legitimate, and legally binding, arrangements already entered into. The problem is that the provision applies to the carrying out of a scheme without clearly indicating that schemes commenced before a specified date or grandfathered, will be excluded from the application of the section.[63]

Professional Investment Services likewise raised concerns regarding the ability for existing legitimate arrangement to fall foul of the anti-avoidance provisions:

> The legislation is not clear that anti-avoidance provisions will only apply for schemes entered into at the commencement of the legislation, or at the very least from the announcement of FoFA. The concern is that existing legitimate arrangements could be caught up by the anti-avoidance provision due to the lack of clarity around the effective date which the provision applies to. We note the legislative handbook setting out the importance of providing for retrospective legislation in exceptional circumstances. For the avoidance of doubt the application of this provision must be clarified and commencement should be for schemes entered into at commencement of legislation or at the very least the announcement of FoFA.[64].

Coalition Committee members are concerned that the lack of time to consult and review this catch-all provision will create uncertainty in the industry and greater red tape and costs. We also want to ensure that the provisions apply prospectively to avoid any unintended consequences through retrospective application.

Recommendation 14

The anti-avoidance provision must only apply prospectively and not capture or render existing legal arrangements as unlawful. The provision should be amended to carve out legally permitted, exempted or grandfathered arrangements.

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63 Financial Services Council, *Submission 58*, p. 38.

64 Professional Investment Services, Submission 17 (supplementary), p.3.

New ASIC powers

Coalition Committee members support the enhancement of ASIC powers that would enable the corporate regulator to more effectively regulate the financial services industry and eliminate any minority rogue elements within the industry.

Our support is directly in line with the recommendations made by the Ripoll Inquiry to provide such enhanced powers to ASIC.

We express our strong concern that the government's continued uncertainty and prevarication in settling on its FOFA changes has delayed the introduction of such important and necessary powers as recommended by the Ripoll Inquiry, which reported more than two years ago.

We also note the concerns expressed by some organisations who submitted to the Committee that ASIC's proposed new powers under the Bill are too broad.

The Joint Accounting Bodies submitted that:

> For us, the issue of giving any regulator such a broad power was not something that we looked at lightly. However we had to look at what is best for the clients and protecting their interest. ASIC has told us that often they have been hamstrung in taking the necessary action because of the existing legislation so giving them these powers would then allow them to take those actions. However we do not want to give ASIC carte blanche and we think that they need to set out in strict terms the circumstances in which they will use those powers and how they will use those powers and how people can then appeal against the use of those powers. Our concern was making sure that if ASIC had this power that there were some rules around it and they did not just have the capacity to take whatever action they wanted.[65]

The Law Council of Australia commented:

> The Committee is concerned by the breadth of the discretion these powers give to ASIC. There is no standard of proof which must be satisfied by ASIC and no prescription of the matters which go to whether a person is "likely to contravene" their obligations. Given the consequences that can flow from an exercise of ASIC's powers under new sections 913B(1)(b), 915C(1)(aa), 920A(1)(f) and 920A(1)(h), including the closure of a licensee's business, the Committee submits that what is required in order for ASIC to form the view that a licensee is "likely to contravene" their obligations should be subject to greater certainty.[66]

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65 Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, *Committee Hansard,* 24 January 2012, p. 54.

66 Law Council of Australia, *Submission 55*, p. 3.

The Financial Services Council called for assurances that the enhanced powers will only be enforced following a hearing:

> Given the widening of ASIC's powers, the legislative scheme should ensure that all decisions involving the exercise of those powers should be made after affording affected individuals or licensees an opportunity to appear at a hearing and to make submissions to ASIC, and all decisions should be reviewable by the Administrative Appeals Tribunal and Federal Court.[67]

Coalition Committee members want to see ASIC act proactively and effectively to ensure that wherever possible rogue elements are detected and prevented from operating in the financial services sector in Australia as soon as possible.

However, we consider that the exercise of these powers should be subject to appropriate safeguards including the long standing principles of procedural fairness that apply to administrative decision making and allow for appropriate administrative and judicial review.

Recommendation 15
That Parliament ensures that the exercise of the enhanced ASIC powers contained in this Bill is subject to appropriate administrative and judicial review in the same way as other decisions made by government agencies.

Intra Fund Advice not defined by FOFA legislation

Intra fund advice is the provision of financial advice by superannuation funds to their members.

Currently, the term 'intra fund advice' and the advice provided by various superannuation funds ranges widely from very general advice, product specific advice, advice on retirement options or even more specific or individualised 'holistic' financial advice.
Today intra fund advice only exists by an ASIC Class Order exemption. Coalition Committee members consider that if intra fund advice is to continue to be provided in the future it should be provided under the same legislative and regulatory framework as all other financial advice.

Despite intra fund advice clearly being to type of financial advice there is no definition or scope of such advice provided in the FOFA legislation. There is no limitation placed on what may constitute intra fund advice and there are no provisions determining who should pay for such advice.

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[67] Financial Services Council, *Submission 58*, p. 21.

Coalition Committee members consider that the complete lack of consideration, definition or restriction of intra fund advice within the FOFA legislation is a serious omission on the part of the government that exposes consumers to severe risks.

This is particularly the case because intra fund advice would not be subject to any best interests duty and because many industry super funds currently fund such intra fund advice by levying fees for this advice on all fund members. This creates a situation where all those fund members who do not access such advice are subject to a secret commission and results in a cross-subsidy for the benefit of those members who do access the advice.

Given the reliance of many industry super funds on the provision of intra fund advice for marketing advantage and the attraction of new members, we are concerned that the government has avoided defining and limiting the scope of intra fund advice because it has bowed to the interests of the union-dominated industry super funds.

Coalition Committee members strongly recommend that intra fund advice should be defined in the FOFA legislation, that there be express limitations to ensure that such advice is general in nature only (similar to the provisions relating to basic banking products) and that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty and be paid for by the person accessing this advice without any cross-subsidy from other fund members.

Recommendation 16

That the FOFA legislation be amended to:

1. **Provide a comprehensive definition of the term 'intra fund advice';**
2. **Ensure that 'intra fund advice' is general in nature only, similar to the provisions relating to basic banking products;**
3. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty;**
4. **Ensure that any financial advice accessed within a superannuation fund beyond such general advice be paid for by the person accessing this advice without any cross-subsidy from other fund members; and**
5. **Repeal the existing ASIC Class Order exemption as it would be superfluous once intra-advice is properly defined within the FOFA legislation.**

Senator Sue Boyce | **Senator Mathias Cormann**

Mr Paul Fletcher MP | **Mr Tony Smith MP**