Parliamentary Joint Committee on Corporations and Financial Services

Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

February 2012

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Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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Abbreviations

AAP	Associated Advisory Practices
AAT	Administrative Appeals Tribunal
ABA	Australian Bankers' Association
ADI	Authorised Deposit-taking Institutions
AFA	Association of Financial Advisers
AFSL	Australian Financial Services Licence
AFTS	Australia's Future Tax System
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATHOC	Australian Timeshare and Holiday Ownership Council
BFPPG	Boutique Financial Planning Principals Group
BSS	Burrell Stockbroking and Superannuation
CCI	Consumer credit insurance
CSSA	Corporate Superannuation Specialist Alliance
EM	Explanatory Memorandum
FDS	Fee Disclosure Statement
FOFA	Future of Financial Advice
FOS	Financial Services Ombudsman
FPA	Financial Planning Association
FSC	Financial Services Council
FSG	Financial Services Guide
FSRA	Financial Services Reform Act
ISN	Industry Super Network

JAB	Joint Accounting Bodies
JCG	Joint Consumer Groups
MIS	Managed Investment Schemes
NIBA	National Insurance Brokers Association of Australia
OBPR	Office of Best Practice Regulation
PIS	Professional Investment Services
PJC	Parliamentary Joint Committee on Corporations and Financial Services
PSB	Professional Standards Board
RIS	Regulatory Impact Statement
SAA	Stockbrokers Association of Australia
SOA	Statement of Advice

Recommendations

Recommendation 1

3.64 The committee recommends that subsection 962F(3) of the Corporations Amendment (Future of Financial Advice) Bill 2011 be reviewed with a view to providing access to recourse for consumers who have had fees wrongfully deducted.

Recommendation 2

3.65 The committee recommends that 'minimum disclosure' guidelines be included in the regulations of the Corporations Amendment (Future of Financial Advice) Bill 2011 for fee disclosure and opt-in notices, stipulating a standard for communication between financial advisers and their retail clients.

Recommendation 3

3.66 The committee recommends that the Explanatory Memorandum to the Corporations Amendment (Future of Financial Advice) Bill 2011 be amended to better explain the annual fee disclosure obligations for existing retail clients.

Recommendation 4

4.70 The committee recommends a revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be issued such that the final sentence in paragraph 1.33 of the Explanatory Memorandum reads:

'In identifying the advice that has in effect been sought by the client (including advice implicitly sought by the client), the provider must take into account the client's relevant circumstances.'

Recommendation 5

5.37 The committee recommends that regulations pertaining to paragraph 964A(3) of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be drafted to include a materiality threshold to determine when a benefit is not presumed to be a volume-based shelf-space fee. The regulations should specify that full disclosure is required for the payment and receipt of these benefits.

Recommendation 6

5.38 The committee recommends that the Australian Securities and Investments Commission (ASIC) issue guidance material for platform operators who seek to substantiate a claim that a volume-based payment demonstrates a reasonable fee for service or a genuine value of scale efficiencies.

Recommendation 7

5.65 The committee recommends that the Australian Securities and Investments Commission (ASIC) conduct shadow shopping exercises on advice pertaining to life risk insurance outside superannuation post implementation of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. ASIC should report its findings back to this committee within two years of the date the Bill commences.

Recommendation 8

5.80 The committee recommends that post-implementation, Treasury work with the Australian Securities and Investments Commission (ASIC) to monitor closely the quality of advice on the sale of risk insurance inside and outside superannuation and any market distortions that may occur.

Recommendation 9

6.35 The committee recommends that further material be provided in the Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 to outline examples of legitimate training, such as practice management or client relationship skills. Legitimate forms of training should also be provided in the regulations.

Recommendation 10

6.39 The committee recommends that the Explanatory Memorandum for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended to provide clarity on the application of the $300 limit for soft-dollar benefits. Further, the committee recommends that examples of what is and is not deemed to be 'frequent or regular' should be stated in the Explanatory Memorandum and the regulations.

Recommendation 11

6.45 The committee recommends that the proposed consultations on the regulations for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 include consideration of the potential impact of restricting soft-dollar benefits of professional development to within Australia and New Zealand.

6.46 The committee recommends that no geographical restriction be placed on professional development where it is professional development focussed on education and training.

Recommendation 12

7.17 The committee recommends that the Australian Securities and Investments Commission (ASIC) provide regulatory guidance material on how Australian Authorised Deposit-taking Institutions (ADIs) can prove that remuneration does not 'reasonably influence' advice.

Recommendation 13

7.50 The committee recommends that the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended so that the Timeshare industry is precluded from the bans on conflicted remuneration.

Recommendation 14

9.17 The committee recommends that the government should amend the footnote references to Rice Warner estimates in the regulation impact statements of the Explanatory Memorandums to both bills. The new footnote should be updated to reflect Rice Warner's revised estimate of the employment impact of the Future of Financial Advice reforms.

Recommendation 15

10.45 The committee recommends that there should be an independent review of the application of the Future of Financial Advice (FOFA) legislation. The review should be timed to comment constructively on how stakeholders have complied with, and interpreted the FOFA provisions. To this end, the committee recommends that an initial report should be given to government by the end of 2013 and a further report by the end of 2014.

Chapter 1

Introduction and background to the inquiry

Conduct of the inquiry

1.1 On 13 October 2011, the House of Representatives referred the Corporations Amendment (Future of Financial Advice) Bill 2011 to the committee for inquiry and report.[1] On 24 November 2011, the House of Representatives referred the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 to the committee for inquiry and report.[2] The two Bills propose to amend the *Corporations Act 2001* (Corporations Act) to change the way the financial advice industry in Australia is regulated.

1.2 The committee advertised the inquiry on its website and in *The Australian*, and invited submissions from interested individuals and organisations. The committee received 69 submissions, as listed in Appendix 1. Two days of public hearings were held in Sydney on 23 and 24 January 2012. A full list of witnesses who gave evidence at the hearings is at Appendix 2. The committee thanks those individuals and organisations who made submissions, and those which gave evidence at public hearings.

Background to the inquiry

1.3 The two Bills currently before the committee represent the government's response to this committee's 2009 inquiry into financial products and services in Australia. The recommendations of that inquiry, and the subsequent consultation processes undertaken by government that led to the current legislation, are outlined below to give context to this inquiry.

The financial advice industry in Australia

1.4 The financial advice industry in Australia comprises over 750 adviser groups operating over 8,000 practices and employing around 18,200 people.[3] Advisers work for authorised businesses holding an Australian Financial Services Licence (AFSL) under the Corporations Act. The majority of financial advisers work for one of the approximately 160 dealer groups currently operating in Australia, and the largest 20 dealer groups hold approximately 50 per cent of the market share.[4]

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1 Selection Committee Report, *House of Representatives Hansard*, 13 October 2011, p. 11873.

2 Selection Committee Report, *House of Representatives Hansard*, 24 November 2011, p. 13849.

3 Australian Securities and Investments Commission, *Report 224*, 'Access to financial advice in Australia', December 2010, p. 30.

4 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 16.

1.5 Many Australians are the recipients of financial advice; according to recent survey data the 20 largest licensees offering financial product advice to retail clients had around 4 million clients in 2010, of which 1.5 million were considered 'active clients'.[5]

1.6 Various business models are used within the financial advice industry. The industry includes: medium to large sized advisory dealer groups which operate similar to a franchise; institutional-owned financial adviser firms with employed advisers; and smaller, independent advisory firms with their own licence.[6] These firms operate using a range of remuneration models:

> Financial advisers are paid through a variety of remuneration models, including fee-for-service, commissions and bonuses. Fee-for-service charges are paid by clients to the adviser and may be an hourly rate or a proportion of funds under management. Commissions are paid by product manufacturers to advisers, usually as up-front payments as a proportion of the investment or as an ongoing trailing commission. Bonuses are generally paid by manufacturers to providers for meeting certain volume targets.[7]

Regulation of the financial advice industry in Australia

1.7 The regulation of the financial services industry is overseen by the Australian Securities and Investments Commission (ASIC). The existing regulatory regime has been designed to maximise market efficiency, with minimal regulatory intervention to protect investors.[8]

1.8 ASIC is responsible for the granting and cancelling of AFSLs. A licence granted to a business will specify the scope of financial services they are authorised to offer, and applicants must demonstrate to ASIC that they will be able to meet the licence conditions. ASIC is responsible for ensuring compliance with licence conditions, which it carries out through monitoring, surveillance and intervention measures.[9]

1.9 Protection for investors is currently limited to conduct and disclosure obligations placed upon AFSL holders. Part 7.7 of the Corporations Act requires providers of financial product advice to retail clients to comply with certain conduct

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5 Australian Securities and Investments Commission, *Report 251: Review of financial advice industry practice*, September 2011, p. 6.

6 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 16.

7 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 17.

8 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 7.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 8–9, 15.

and disclosure obligations, which vary depending on whether the advice is personal advice or general advice. Personal advice is defined as advice given in circumstances where the provider has considered the client's objectives, financial situation and needs. 'General advice' refers to financial product advice that is not personal advice.[10]

1.10 In cases where personal advice is being given, disclosure obligations include preparing a Financial Services Guide (FSG) for a client receiving advice as well as a Statement of Advice (SOA) for each piece of advice given.

1.11 An FSG is a general document provided at the commencement of an advice relationship, which must outline the kinds of financial services and products the licensee is authorised to provide, as well as any remuneration, commission and other benefits that may be received by the providing entity as a result of advice being offered and any potential conflicts of interest.[11]

1.12 An SOA outlines personal advice provided to a client regarding a financial product or service, and must include information such as details of remuneration arising from the advice and possible conflicts of interest, in addition to the advice itself and information explaining the basis for the advice.[12]

1.13 As well as disclosure obligations, licensees must adhere to certain conduct obligations, including a requirement that advisers providing personal advice must ensure that there is a reasonable basis for that advice. This is often referred to as the 'suitability rule', and is stipulated in section 945A of the Corporations Act, as follows:

> (1) The providing entity must only provide the advice to the client if:
>
> (a) the providing entity:
>
> (i) determines the relevant personal circumstances in relation to giving the advice; and
>
> (ii) makes reasonable inquiries in relation to those personal circumstances; and
>
> (b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and
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> (c) the advice is appropriate to the client, having regard to that consideration and investigation.

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10 ASIC, *Regulatory Guide 175*, 'Licensing: Financial product advisers – Conduct and disclosure', April 2011, p. 4.

11 ASIC, *Regulatory Guide 175*, 'Licensing: Financial product advisers – Conduct and disclosure', April 2011, pp 21-23.

12 ASIC, *Regulatory Guide 175*, 'Licensing: Financial product advisers – Conduct and disclosure', April 2011, pp 45–48.

Previous committee inquiry into financial products and services in Australia

1.14 In February 2009, the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into issues associated with the provision of financial products and services in Australia. The inquiry was initiated in response to a string of high profile collapses of financial product and service providers, such as Storm Financial and Opes Prime.

1.15 The committee investigated a wide range of issues including the role of financial advisers, commission arrangements relating to product sales and advice; the adequacy of licensing arrangements for financial product and service providers; consumer information and protection relating to financial services and products; and the need for any legislative or regulatory change.[13]

Recommendations of the PJC report

1.16 The committee's final report in November 2009 (the PJC report) found that significant changes to the regulatory regime for the financial advice industry were warranted. It made a series of recommendations designed to 'enhance professionalism within the financial advice sector and enhance consumer confidence and protection',[14] as outlined below.

Introducing a statutory fiduciary duty for financial advisers

1.17 The committee found that some financial advisers were not acting in the best interests of their clients, but rather promoting investment products based predominantly on their own interests (e.g. by promoting products from which they received commission payments).

1.18 The committee recommended that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.[15]

Remuneration practices and conflicts of interest

1.19 The committee found that remuneration structures which involve payments from product manufacturers to advisers, such as product commissions, constitute a significant conflict of interest for financial advisers, and are inconsistent with the proposed fiduciary duty for advisers to act in their clients' best interests. Accordingly,

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13 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. vii.

14 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 149.

15 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 110.

the committee recommended that the government consult with and support the industry in developing the most appropriate mechanism by which to cease payments from financial product manufacturers to financial advisers.[16]

1.20 The committee also found that potential conflicts of interest and restrictions on the advice certain financial advisers can give (e.g. where an adviser is limited to discussing only certain financial products) were not easily apparent in disclosure documents and marketing materials provided to clients by financial advisers. The committee recommended that the Corporations Act be amended to require advisers to disclose prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest.[17]

Expanding ASIC's regulatory powers and enforcement activities

1.21 The committee made four recommendations concerning ASIC's statutory powers as the financial services regulator and its enforcement activities in this area.[18]

1.22 The committee found firstly that ASIC could do more to enforce the current legislative standards relating to the provision of financial advice. The committee recommended that the government ensure ASIC is appropriately resourced to perform effective risk-based surveillance of the advice provided by AFSL holders, and that ASIC should conduct financial advice shadow shopping exercises annually.[19]

1.23 In addition to enforcement activities, the committee found that ASIC did not have sufficient powers to ban licensees where there was a suspicion they would not comply with their obligations under the licence. Additionally, ASIC was unable to ban individual financial advisers from the industry, instead only being permitted to ban businesses at a licensee level,[20] which prevented individuals operating at the fringes of the industry from being suspended.[21]

16 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 127.

17 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 115.

18 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 111, 139–141.

19 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 111. In this context shadow shopping exercises involve ASIC officials posing as consumers and obtaining financial advice from providers to determine its quality and compliance with regulations.

20 AFSLs are granted to financial service businesses, which then authorise individual employees to operate under the terms of that licence.

21 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 135, 139.

1.24 Accordingly, the committee recommended that the Corporations Act be amended to allow ASIC to ban individuals from the financial services industry, and to allow ASIC to deny an application, or suspend or cancel an AFSL, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.[22]

Establishment of a professional standards board

1.25 The committee recommended that ASIC begin consultation with the financial services industry on the establishment of an independent, industry-based Professional Standards Board (PSB) to oversee nomenclature, and competency and conduct standards for financial advisers.

1.26 The committee considered that such a board would increase professionalism in the industry by ensuring that those wishing to call themselves 'financial advisers' or 'financial planners' would be required to obtain membership and adhere to the board's standards. It would work in conjunction with ASIC to establish, monitor and enforce competency and conduct standards amongst members and have the power to sanction or remove those who do not comply.[23]

Investor compensation

1.27 The committee considered the issue of what compensation arrangements should be in place for consumers who lose money through the collapse of AFSLs. It noted that public indemnity insurance held by licensees is generally insufficient to cover losses sustained during significant corporate collapses, and that a 'last resort' statutory compensation fund covering licensee wrongdoing, while an appealing option, had significant challenges associated with it.

1.28 The committee recommended that the government investigate the costs and benefits of different models of a statutory 'last resort' compensation fund for investors.[24]

Other issues

1.29 The committee also made recommendations on three other issues of relevance to the industry.

1.30 The committee considered a proposal to make the cost of obtaining financial advice tax deductible for consumers, and recommended that the government consider

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22 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 139–141.

23 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 141.

24 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 146.

the implications of this proposal as part of its response to the Treasury review of the tax system.[25]

1.31 Another issue discussed by the committee was the adequacy of capital arrangements for AFS licensees, and particularly the capital adequacy of agribusiness Managed Investment Schemes (MIS) in Australia. While the committee made no recommendation about capital arrangements for AFSLs generally, it did recommend that ASIC require agribusiness MIS licensees to demonstrate they have sufficient working capital to meet current obligations as part of their licence conditions.[26]

1.32 Finally, the committee noted its view that ASIC could be doing more to educate key, higher risk, older demographic groups by promoting sensible investment messages, and recommended that ASIC develop and deliver more effective education activities targeted to groups in the community who are likely to be seeking financial advice for the first time.[27]

Government response – the Future of Financial Advice reforms

1.33 In response to the PJC report, in April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, announced reforms to 'improve the trust and confidence of Australian retail investors in the financial planning sector'.[28]

1.34 The initial reform announcement supported nine of the PJC's eleven recommendations, as well as proposing several additional measures to overhaul the financial advice industry.

Response to the PJC recommendations

1.35 Five of the PJC's recommendations were taken up directly in the government's reform package, while four recommendations were supported in principle and two were not supported by government.

1.36 The recommendations adopted directly include the introduction of a statutory fiduciary duty for advisers to act in their clients' best interests, strengthening ASIC's enforcement powers and ceasing payments from product manufacturers to financial advisers. The government strengthened the recommendation to cease payments from product manufacturers to financial advisers to include a ban on conflicted

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25 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 127–128.

26 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 140.

27 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 147.

28 The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010.

remuneration practices such as commission payments and payments relating to volume or sales targets, as well as banning percentage-based fees on geared investments.[29]

1.37 In line with the PJC's recommendation, the government commissioned an independent study, undertaken by the financial services and corporate governance expert Richard St. John, into the merits of a last resort statutory compensation scheme for consumers of financial services. Mr St. John released a consultation paper in April 2011 into these issues, and received public submissions until June 2011.[30] The final outcome of the study has not yet been made public.

1.38 The government also expressed in principle support for the PJC's recommendations relating to ASIC's role in providing risk-based surveillance of the financial advice industry, offering increased financial education initiatives to target groups in the community, and more closely monitoring capital requirements of agribusiness MIS licensees.

1.39 It also supported the PJC's recommendation that the government consider the implications of making the cost of financial advice tax deductible for consumers as part of its response to the Treasury review into the tax system. However, this issue was not mentioned in the government's initial response to the *Australia's Future Tax System* (AFTS) review that was released in May 2010.

1.40 The government did not support two of the PJC's recommendations. These related to the disclosure of potential conflicts of interest and limits on advice in marketing material, and ASIC consulting on the establishment of a PSB for the financial advice industry.

1.41 With regards to increased disclosure of potential conflicts of interest and limits on advice in marketing material, the government response noted that it is difficult for a range of restrictions and conflicts to be disclosed in various forms of marketing material, and that the government would act to improve disclosure regarding financial advisory services provided to consumers, through simplifying disclosure in FSGs.[31]

1.42 With regards to the establishment of a PSB, the government noted concern about the costs of a separate PSB, which could be passed on to consumers, and for the potential for significant overlap with the role of ASIC in enforcing competency and

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29 The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010, pp 8–9.

30 Treasury, 'Review of compensation arrangements for consumers of financial services', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/compensation_arrangements_CP/default.htm (accessed 3 January 2012).

31 The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010, pp 8–10.

conduct standards.[32] While not supporting the establishment of a separate PSB, the government announced a review of professional standards in the industry by an expert advisory panel (see below).

Additional government proposals

1.43 In addition to the PJC's recommendations, the government announced several additional proposals as part of the Future of Financial Advice (FOFA) reform package. These included:

- the introduction of a new 'adviser charging' regime, with an annual renewal notice required for advisers entering ongoing fee arrangements with clients;
- improving access to simple or limited advice to assist in the affordability of advice, by removing regulatory barriers;
- removing the current exemption permitting accountants to provide advice on the establishment and closing of self-managed superannuation funds without holding an AFSL; and
- consulting on the appropriateness of the current criterion under which a client is classified as retail or wholesale.[33]

Consultation process

1.44 Treasury undertook a consultation process throughout the development of the FOFA reforms. A peak consultation group, comprising key industry and consumer stakeholders as well as ASIC, was established to facilitate this process. Treasury also held public information sessions relating to the FOFA reforms in June and July 2010 and February and March 2011 in Adelaide, Brisbane, Melbourne, Perth and Sydney.[34]

Establishment of expert advisory panel

1.45 On 24 November 2010, the government announced the establishment of an advisory panel on financial advice and professional standards as part of its FOFA reforms. The panel was established to provide views on:

- professional and ethical standards in the financial advice industry, including the possible development of a best practice guide for financial advisers;
- the competency requirements that must be satisfied by financial services professionals regulated by the Corporations Act;

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32 The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010, p. 10.

33 The Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Overhaul of Financial Advice', *Media Release No. 036*, 26 April 2010, p. 9.

34 Treasury, 'Future of Financial Advice: Consultation', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation.htm (accessed 9 January 2012).

- the training requirements for people providing financial product advice;
- the extent to which material soft-dollar benefits[35] are consistent with any ethical standards imposed on financial advisers; and
- proposals regarding how training should be tested or assessed.[36]

Second round of FOFA announcements – April 2011

1.46 The government released an additional round of information in April 2011 relating to the FOFA reforms. This package included modifications to several of the proposals previously announced, including:

- extending the ban on conflicted remuneration to include 'soft dollar' benefits over a certain threshold (proposed to be $300), and a ban on commissions for both individual and group risk insurance within superannuation from 1 July 2013;
- an exemption from elements of the ban on conflicted remuneration and best interests duty for employees of Authorised Deposit-taking Institutions (ADIs) selling basic banking products; and
- a change to the proposed 'adviser charging regime', under which clients would need to 'opt–in' via a renewal notice every two years, supplemented by an annual disclosure statement.[37]

1.47 The government also announced that it would explore whether the term 'financial planner/adviser' should be restricted under the Corporations Act. Further details of the April 2011 update are outlined in Diagram 1.1 and Diagram 1.2 below.

Exposure draft legislation

1.48 On 29 August 2011, the government released exposure draft legislation for the *Corporations Amendment (Future of Financial Advice) Bill 2011*, including details on measures such as the statutory best interests test, compulsory renewal requirement (opt-in), and the enhancement of ASIC's powers. Consultation on this exposure draft closed on 16 September 2011, with 47 submissions received.[38]

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35 'Soft dollar' benefits are any non-monetary benefits received by a party as part of a remuneration arrangement for services provided.

36 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Government announces financial advice advisory panel membership', *Media Release No. 015*, 24 November 2011, p. 1.

37 Australian Government, 'Future of Financial Advice 2011: Information Pack', 28 April 2011, pp 5-6.

38 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice reforms – Draft legislation', *Media Release No. 127*, 29 August 2011; Treasury, 'Exposure Draft – Corporations Amendment (Future of Financial Advice) Bill 2011', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/corporations_amend/default.htm (accessed 9 January 2012).

1.49 On 28 September 2011 the government released exposure draft legislation for the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*. This Bill implements further aspects of the FOFA reforms including the proposed ban on conflicted remuneration. Consultation on this exposure draft closed on 19 October 2011, with 48 submissions received.[39]

1.50 Diagram 1.1 outlines the initial PJC recommendations, how they have been taken up or modified in the government's response, and where applicable the provisions in the current Bills relating to each. Diagram 1.2 outlines the additional proposals that the government has announced as part of the FOFA reforms.

Structure of the report

1.51 This report consists of 10 chapters. Chapter 1 has outlined the conduct of the inquiry and the background to the FOFA reforms. Chapter 2 then provides an overview of the provisions of the two FOFA Bills. Chapters 3-8 discuss stakeholder views on the provisions of the Bills.

1.52 Chapter 3 discusses the provisions relating to the 'opt-in' and fee disclosure regime. Chapter 4 discusses the proposed statutory obligation for advisers to act in the best interests of their clients.

1.53 Chapters 5-7 deal with the provisions of the Bill relating to the ban on conflicted remuneration. Chapter 5 provides a look at the proposed conflicted remuneration bans, then chapter 6 considers the anti-avoidance provisions on volume based fees and the proposed ban on soft dollar benefits. Chapter 7 finishes this section by discussing the proposed carve-outs from the conflicted remuneration ban for basic banking products and stockbrokers.

1.54 Chapter 8 discusses ASIC's proposed additional statutory powers under the Bill.

1.55 Chapters 9-10 examines the process of the FOFA reforms and their possible impact. Chapter 9 canvasses the expected impact of the FOFA reform package on the financial services industry, while Chapter 10 examines the implementation process of the FOFA reforms and the consultation process undertaken in the development of the legislation.

39 Joint Consumer Submission, *Submission 25*, p. 6; Treasury, 'Exposure Draft - Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/corporations_further/default.htm (accessed 9 January 2012).

Diagram 1.1 – PJC recommendations and subsequent FOFA reform measures

PJC Recommendation	Government Response (April 2010)	Government update (April 2011)	Current legislation
1. The committee recommends that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.	Support the introduction of a statutory fiduciary for financial advisers to act in the best interests of their clients, including a 'reasonable steps' qualification outlining steps advisers must take to fulfil this duty.	Duty to be based on how a person acted rather than the outcomes of an action. Consultation with industry on the form of the statutory duty is taking place.	FOFA bill No. 2 [1] Covered in Division 2, ss. 961-961Q. 'Best interests' requirement and procedural steps for satisfying it (s961B). Requirement for advice to be appropriate to client, replacing s945A (s961G). Provider must preference the client's interest in the case of a conflict of interest (s961J).
2. The committee recommends that the government ensure ASIC is appropriately resourced to perform effective risk-based surveillance of the advice provided by licensees and their authorised representatives. ASIC should also conduct financial advice shadow shopping exercises annually.	Support in principle. The government believes that ASIC is appropriately resourced to perform its functions.	N/A	N/A

1 In this table 'FOFA Bill No. 1' refers to the *Corporations Amendment (Future of Financial Advice Measures) Bill 2011* while 'FOFA Bill No. 2' refers to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*.

PJC Recommendation	Government Response (April 2010)	Government update (April 2011)	Current legislation
3. The committee recommends that the Corporations Act be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest.	Do not support. Difficult for a range of restrictions and conflicts to be disclosed in various forms of marketing material. Government is already acting to improve disclosure of advisory services to consumers, through simplifying disclosure in FSGs.		
4. The committee recommends that the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers.	Support with additional strengthening - a ban on 'conflicted remuneration' including commission payments, volume-based payments and asset-based fees on borrowed amounts.	Ban expanded to include 'soft-dollar' benefits over a threshold value (proposed $300) and risk insurance within superannuation. Exemption from this ban for basic banking products. *Note: an exemption for general insurance products was also introduced in the Exposure Draft legislation in September 2011.*	FOFA Bill No. 2 Definition of conflicted remuneration (s963A) and exemptions(ss. 963B-963D). Ban on conflicted remuneration (ss. 963E-963L). Ban on volume-based shelf-space fees (ss. 964-964A). Ban on asset-based fees on borrowed amounts (ss. 964B-964G).
5. The committee recommends that the Government consider the implications of making the cost of financial advice tax deductible for consumers as part of its response	Supported, noting that the government's response to the Treasury review of the	N/A - The government's May 2010 response to the	N/A

PJC Recommendation	Government Response (April 2010)	Government update (April 2011)	Current legislation
to the Treasury review into the tax system.	tax system would be released in May 2010.	AFTS review did not mention this issue.	
6. The committee recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry.	Support. Government intend to adopt the changes recommended by the committee.	No change.	FOFA Bill No. 1 Items 5-7. ss. 920A(1)(ba), 920A(1)(d), 920(1)(da) and 920A(1)(f).
7. The committee recommends that, as part of their licence conditions, ASIC require agribusiness MIS (managed investment scheme) licensees to demonstrate they have sufficient working capital to meet current obligations.	Support in principle, noting that implementation is a matter for ASIC.	On 30 January 2012, ASIC released an investor guide and regulatory guide 232, *Agribusiness managed investment schemes: Improving disclosure for retail investors*, dealing with issues relating to investing in an agribusiness MIS.	
8. The committee recommends that sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.	Support. Government intend to adopt changes recommended by the committee.	No change.	FOFA Bill No. 1 Items 2-4. ss. 913B(1)(b), 913B(4)(a), and 915C(1)(aa).
9. The committee recommends that ASIC immediately begin consultation with the financial services industry on the establishment of an independent, industry-based professional standards board (PSB) to oversee nomenclature, and competency and conduct standards for financial advisers.	Do not support. Government acknowledges current arrangements for professional standards could be enhanced, however is concerned about the cost of establishing a separate PSB, which may be passed on to consumers, and the potential overlap with ASIC's role. *Instead, the government established an expert advisory panel in November 2010 to review professional standards including competency and conduct standards.*		

PJC Recommendation	Government Response (April 2010)	Government update (April 2011)	Current legislation
10. The committee recommends that the government investigate the costs and benefits of different models of a statutory last resort compensation fund for investors.	Support. Government appointed Richard St. John to undertake a study on this issue.	Consultation paper from Richard St. John released. Submissions closed June 2011. Final report not yet published.	N/A
11. The committee recommends that ASIC develop and deliver more effective education activities targeted to groups in the community who are likely to be seeking financial advice for the first time.	Support in principle.	N/A	N/A

Diagram 1.2 FOFA reforms - additional Government proposals

Government proposal (April 2010)	Government Update (April 2011)	Current legislation
1. The exemption permitting accountants to provide advice on the establishment and closing of self-managed superannuation funds without holding an AFSL will be removed.	Government, ASIC and industry working to develop initiatives to replace the current exemption.	N/A
2. Improve access to simple or limited advice to assist in the affordability of advice, by removing regulatory barriers.	Government intends for amendments to be made to the Corporations Act to ensure that the provision of scaled advice is consistent with licensees' obligations under the Act.	No provisions explicitly relating to scaled advice, however the EM to FOFA Bill No. 2 states that the provisions relating to the 'best interests' obligation have been drafted so as to facilitate the

	ASIC Consultation Paper 164, *Additional guidance on how to scale advice*, released on 28 July 2011.	provision of scaled advice.[2]
3. Introduce a new 'adviser charging' regime with an annual renewal notice required for ongoing fee arrangements.	Clients will need to 'opt-in' to ongoing advice fees via a **renewal notice every two years**. Renewal notice to be supplemented by an **annual fee disclosure statement** detailing fee and service information for the previous and forthcoming year. These measures are to apply prospectively.	FOFA Bill No. 1 Covered in Division 3, ss. 962-962S. Definitions of ongoing fee arrangements (ss.962A-C) Fee disclosure statements (s962H) Renewal notice (s962K).
4. Improve and simplify disclosure on the nature of financial services offered to investors.	ASIC released an updated version of Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, in April 2011, to assist licensees in preparing disclosure documents.	N/A
5. Consult on the appropriateness of the current criterion under which a client is classified as retail or wholesale.	Options paper released in January 2011, receiving around 45 submissions. The government is currently considering its response.	N/A
N/A	Government to explore whether the term 'financial planner/adviser' should be restricted under the Corporations Act (introduced April 2011).	N/A

2 *Corporations Amendment (Further Future of Advice Measures) Bill 2011*, Explanatory Memorandum, p. 12.

Chapter 2

Provisions of the Bills

2.1 This chapter outlines the provisions of the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

2.2 These two Bills provide for the implementation of the Future of Financial Advice (FOFA) government reforms first announced by the then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, on 26 April 2010.

2.3 The Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, summarised the purpose of the reforms:

> It is a concern that only one in five Australians access financial advice. These reforms will restore trust and confidence in the sector following collapses such as Storm, Westpoint and Trio. They also remove the red tape that has prevented low-cost, good quality advice being delivered to millions of Australians.[1]

2.4 Most provisions of the Bills will only apply to clients who receive financial advice from the licensee on or after the commencement day of 1 July 2012.[2] However, there are some exceptions, such as some fee disclosure requirements[3] and the best interests obligations, which apply to all clients from 1 July 2012, regardless of when they first sought advice.

Corporations Amendment (Future of Financial Advice) Bill 2011

2.5 This Bill would amend the *Corporations Act 2001* to:

- require financial advisers to provide a fee disclosure statement to a client when charging advice fees for longer than 12 months;
- require financial advisers to provide a fee disclosure statement and a renewal notice to a client when charging advice fees for longer than 24 months; and

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1 The Hon. Bill Shorten, MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms—Draft Legislation', *Media Release* 127, 29 August 2011.

2 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 15. See also Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962D.

3 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, sections 962R and 962S.

- extend the Australian Securities and Investments Commission's (ASIC) licensing and banning powers used to supervise the financial services industry.

2.6 The Explanatory Memorandum (EM) for the Bill states that:

> The compulsory disclosure and renewal notice obligations will apply to advisers ('fee recipients') in situations where they provide personal advice to a retail client, and the client pays a fee which does not relate to advice that has already been given at the time the arrangement is entered into. This is so the compulsory disclosure and renewal notice obligations apply to ongoing advice fees.[4]

Main provisions of the Bill

Ongoing fee arrangements

2.7 The new provisions for ongoing fee arrangements are set out under *Schedule 1, item 10, division 3*. The Bill defines 'ongoing fee arrangements' (section 962A) and puts in place arrangements that will require financial advisers to obtain their retail clients' agreement every two years to charge them ongoing fees for financial advice (the opt-in requirement).

2.8 For the purposes of this Bill, instalment plans will not be considered as 'ongoing fees'. This is to prevent retail clients from 'opting out' of paying for services already rendered by an adviser.

2.9 The definition of ongoing fees also excludes insurance premiums and fees prescribed as 'product fees'. Product fees will be described in regulations yet to be released. The Minister will have the power to exclude certain arrangements that this Bill is not intended to apply to, including arrangements that do not currently exist. The EM states that this is to ensure that the legislation is kept up to date and effective.[5]

Termination, disclosure and renewal

2.10 The provisions relating to contract termination, disclosure and renewal obligations establish a framework by which retail clients are given the opportunity to renew their ongoing fee arrangements with their financial service providers. It is envisaged that this framework will also encourage greater client engagement by providing greater awareness of the costs and structure of the financial advice received.

2.11 Consistent with current legislation, section 962E stipulates that a retail client will be able to terminate an ongoing fee arrangement at any time, without being

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4 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 7.

5 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 8.

charged a termination fee (except where the client is liable for services already rendered).

2.12 Section 962G provides that fee recipients (as defined in section 962C) will need to provide a fee disclosure statement within 30 days of the 12 month anniversary of the date the arrangement was entered into.

2.13 The required information for fee disclosure statements are outlined in subsection 962H(2). Under these provisions, the fee recipient will need to disclose the amount of ongoing fees charged for the previous 12 months and also the anticipated fees for the upcoming 12 months.

2.14 The provisions stipulate that the nature of the services provided must also be detailed. This includes an outline of services received in the 12 months prior to the disclosure day, and also the services that will be rendered in the forthcoming 12 months, commencing on disclosure day (the day of the 12 month anniversary of the arrangement, see section 962J).

2.15 Subsection 962H(3) will allow regulations to provide details of any other prescribed matters to be included in the fee disclosure statement. Regulations may also provide that certain information is not required to be contained in a fee disclosure statement. The EM states that this regulation-making power serves:

> ...several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants, and to provide efficacy to the legislation.[6]

2.16 Importantly, if a fee recipient does not provide a fee disclosure statement within the required timeframe, the client will not be liable to continue paying the ongoing fee.

2.17 Conversely, if a breach of the fee disclosure requirements occurs and the client continues to pay ongoing fees, the fee recipient is not obliged to refund any fees.[7] It is important to note that the client is not taken to have waived their rights or to have entered into a new arrangement by merely continuing to pay an ongoing fee after a breach of the disclosure obligations.[8]

2.18 Section 962K stipulates that if an ongoing fee arrangement is to remain in place for a period longer than 24 months, the fee recipient must provide the client with

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6 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 9. This section also applies to renewal notices in subsection 962K(3).

7 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

8 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

a renewal notice and a fee disclosure notice within 30 days beginning on the 24 month anniversary of the last day on which that arrangement was agreed to/renewed.

2.19 Subsection 962K(2) sets out the information that must be included in a renewal notice. It is envisaged as a simple form and fee recipients will have flexibility in its presentation. The renewal notice will provide the client with the opportunity to renew their ongoing fee arrangements and it will also set out the consequences should a client elect not to renew the arrangement. If the client does not renew their arrangement, they will lose access to ongoing advice. The fee recipients may choose to include further information in the renewal notice elaborating on the consequences of termination.

2.20 The fee disclosure statement that will be included with the renewal notice will assist the client in assessing whether or not to renew the arrangement.

2.21 Consistent with disclosure obligations, if a client does not notify the fee recipient of his or her intentions, their ongoing arrangement will be terminated at the end of another 30 day period, following the renewal period (section 962N). If a fee recipient does not provide a renewal notice and fee disclosure statement within the required timeframe, the client will not be liable to continue paying the ongoing fee.[9]

2.22 If a client fails to comply with the disclosure obligation and continues to pay ongoing fees, the fee recipient is not obliged to refund any moneys.[10] On the other hand, the client is not taken to have waived their rights or to have entered into a new arrangement by merely continuing to pay an ongoing fee after a breach of the disclosure obligations.[11]

Changes to the Australian Security and Investment Commission's (ASIC's) powers

2.23 The first tranche of the FOFA Bills amends ASIC's licensing and banning powers so as to enhance its ability to supervise the financial services industry. The Bill has a particular focus on individuals: currently ASIC only has the ability to prosecute licensees, not individual advisers, which means individuals providing poor advice may still continue to operate. Under the new provisions, ASIC will have the power to ban these individuals.

2.24 The enhancements to ASIC’s licensing and banning powers are:

9 Corporations Amendment (Future of Financial Advice) Bill 2011, Subsection 962F(2).

10 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

11 Corporations Amendment (Future of Financial Advice) Bill 2011, Subsection 962F (3).

- a change to the licensing threshold so that ASIC can refuse or cancel/suspend a licence where ASIC has a reason to believe a person is likely to contravene (rather than will breach) its obligations;[12]
- extend the statutory tests so that ASIC can ban a person (as opposed to entities) who is not of good fame and character or not adequately trained or competent to provide financial services (in essence they are not a fit and proper person);[13]
- ensure that ASIC can consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions;[14]
- a change to the banning threshold so that ASIC can ban a person if ASIC believes they are likely to (rather than will) contravene a financial services law;[15] and
- clarification that ASIC can ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.[16]

2.25 Moreover, section 965 prohibits advisers from entering into an agreement with a client that would attempt to void their obligations under the package of FOFA amendments.

Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

2.26 In addition to the Corporations Amendment (Future of Financial Advice) Bill 2011, this Bill would amend the *Corporations Act 2001* to:

- require financial advisers to act in the best interests of their clients and to put their client's interests ahead of their own when providing advice;
- ban the payment and receipt of certain remuneration which has the potential to influence the financial product advice given to retail clients;
- ban volume-based shelf-space fees from asset managers or product issuers to platform operators; and
- ban asset-based fees on borrowed client monies.

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12 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 913B(1)(b), 920A(1)(aa).

13 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 920A(1(c)

14 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 913B(4)(a), 920A(1)(g)(h).

15 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 920A(1)(aa).

16 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 20; 920A(1)(1A)(1B).

Provisions of the Bill

2.27 This Bill will introduce two key measures: imposing a statutory best interests duty on financial advisers; secondly, banning conflicted remuneration including commissions from product issuers.

Best interests duty

2.28 In the Second Reading Speech, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, stated:

> The best interests duty is a legislative requirement to ensure the processes and motivations of financial advisers are focused on what is best for their clients. It is true that this will ultimately lead to better advice in many cases, but first and foremost it is about regulating conflicts, not the intrinsic value of the advice provided.[17]

2.29 The Bill requires individuals providing advice to retail clients to prioritise the best interests of their clients in the event of conflict between the interests of the client and the interests of the licensee or the individual providing advice.

2.30 The best interest obligations are set out in Schedule 1, item 23, Subdivision B, Division 2 of Part 7.7A of the Bill and are intended to apply to individual advisers (including advisers issuing advice through computer programs)[18], as well as licensees and authorised representatives. This new focus on individuals provides a clear standard for all advisers. It also enables the industry regulator to ban individuals who provide poor quality advice.

2.31 In addition to the general best interests duty contained in subsection 961B(1), the Bill also sets out a number of steps advisers will need to take so as to ensure compliance with the best interests duty requirements. The EM notes that this list is not intended as an exhaustive checklist, but is an 'indication of what, as a minimum, is expected of providers in order to be considered to have acted in the best interest of the client'.[19]

2.32 Provisions in the Bill replace existing requirements in the Corporations Act to have a reasonable basis for providing advice and to warn clients if advice is premised upon incomplete or inaccurate information with the following obligations:

- to clarify the relationship between the new best interest obligations and these requirements; and

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17 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 24 November 2011, p. 13751.

18 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, Division 2, subsection 961(6).

19 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 10.

- to impose these requirements on the individual who provides the advice.[20]

2.33 Should an individual adviser breach their obligations, penalties for the breach will be imposed against the licensee or authorised representative. The 'individual adviser may also face administrative action in the form of a banning order'.[21]

2.34 The new Bill takes considerable care in explaining the notion of 'reasonableness', which features prominently in the provisions. For example, it requires that advisers conduct 'reasonable investigations' to verify/obtain information provided by the client and to ensure that the correct financial products are recommended, conducive with the client's best interests.[22]

2.35 The phrase 'reasonably apparent' also features prominently. This phrase relates to the obligation of advisers to conduct reasonable inquiries to obtain complete and/or accurate information where it is reasonably apparent that the information provided by a client is incomplete and/or inaccurate.[23] The test for what may be reasonably apparent is determined by what would be apparent to an individual with a reasonable level of expertise in the subject matter of the advice. It is intended as an objective test reliant upon professional standards in the industry.

2.36 If, after reasonable inquiries, client information remains inaccurate or incomplete, advice can still be given, however, the adviser is obliged to warn the client.[24]

2.37 The new Bill seeks to recognise that advice relating to basic banking products and general insurance are better understood by consumers and are relatively simple in nature. Consequently, a modified best interest obligation is applicable.[25]

2.38 The committee notes that there is an apparent error in paragraph 1.54 of the EM to the Bill, which relates to the best interests provisions. Twice in paragraph 1.54 references are made to subsection 961C(1), when this should in fact be subsection 961B(1).

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20 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 7.

21 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 7.

22 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, section 961D.

23 See Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, Division 2, Subdivision B, paragraph 961B(2)(c) and sections 961C and 961D.

24 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, section 961H.

25 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, subdivision B, paragraphs 961B(2)(a), (b) and (c).

Conflicted remuneration and other banned remuneration

2.39 Schedule 1, item 24, Divisions 4 and 5 will amend the Corporations Act to:

> ...ban the payment and receipt of certain remuneration which has the potential to influence the advice licensees provide to retail clients in respect of certain financial product advice.[26]

2.40 'Conflicted remuneration', defined in section 963A of the Bill, includes any monetary or non-monetary benefits given to a licensee or adviser that could reasonably be seen to influence the nature of financial advice provided to retail clients. Payments banned include commissions, volume payments from platform operators[27] to financial advice dealer groups and volume-based shelf-space fees payed by funds managers to platform operators (section 964A). However, section 963L provides that licensees, advisers and platform operators may receive volume-based payments if they can prove that the benefit is not conflicted remuneration.

2.41 Section 963L is particularly important in instances where performance pay constitutes an important part of a remuneration package. The EM states that:

> If an employee is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to volume is presumed to be conflicted. However, if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned.[28]

2.42 Section 963B of the Bill sets out the exemptions from the ban on conflicted remuneration. Paragraph 963B(1)(a) states that benefits given to a licensee or representative solely in relation to a general insurance policy is not considered conflicted. Moreover, in the case of a benefit received from a life insurance company, it is not considered conflicted if the policy relates to individual life risk policies within non-default superannuation funds and on life risk policies sold outside superannuation.

2.43 Additionally, if a benefit or commission is received in relation to an execution-only sale or issue of financial products, it is not considered conflicted

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26 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

27 Retail investment platforms provide a central hub for investors to access a range of investment products, and allow for consolidation of client information and reporting on these assets.

28 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 28.

remuneration. Execution-only sales are where a product is sold with no advice provided to the retail client.[29]

2.44 Section 963A sets out the exceptions to the ban on soft-dollar benefits. Exceptions include benefits given in relation to a general insurance product, benefits under an amount prescribed by regulation (proposed to be $300), benefits with an education or training purpose (to be clarified in regulation), or benefits that provide information technology software or support.

2.45 The Bill will also ban asset-based fees on borrowed amounts.[30]

2.46 Section 964F defines asset-based fees as a fee for providing financial advice that is dependent upon the amount of funds to be used to acquire/buy financial products. A 'borrowed amount' refers to an amount borrowed in any form, secured or unsecured. An exemption is provided if it is not reasonably apparent to the licensee or adviser that the monies used by a retail client are borrowed. The EM states that the test for:

> ...whether something is "reasonably apparent" is an objective one, based on whether it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice, exercising care and assessing the client's information objectively. It is a question of what would be apparent to a prudent adviser.[31]

2.47 Part 7.7A of the Bill sets out the provisions which are subject to civil penalties if breached. The Bill will establish maximum civil penalties of $200,000 for an individual or $1,000,000 for a body corporate.

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29 Schedule 1, item 24, division 4, paragraph 963B(1)(c).

30 Schedule 1, item 24, division 5, subdivision B.

31 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 37.

Chapter 3

Annual fee disclosure and the opt-in obligations

3.1 This chapter examines the annual fee disclosure requirements and the two yearly 'opt-in' provisions contained in the first tranche of the FOFA Bills.[1] Three sections follow:

- the first section discusses submitters' concerns with the fee disclosure notices;
- the second section discusses submitters' concerns with the opt-in (renewal) obligations; and
- the third section outlines the committee view.

3.2 The relationship and fee arrangements that exist between financial advisers and their retail clients are unique to the financial advice industry. Clients often do not pay all of the advisers' fees directly and may be charged ongoing fees for services. In terms of the ongoing component, Treasury explained to the committee that:

> In situations where the client pays a substantial proportion of the adviser's remuneration directly (known as 'fee for service') it is common for this remuneration to be ongoing in nature. For example, an adviser might charge a client an ongoing annual fee calculated as a percentage of the client's funds under management (known as an asset-based fee) or a flat dollar amount. This annual fee generally covers a range of advisory services provided to (or available to) clients. As opposed to professions or other occupations that tend to charge for transactional, one-off services or advice, advisers' remuneration structure is partly reflective of the notion that the benefits of financial advice tend to be realised over the medium to long-term, and therefore remuneration structures tend to reflect the ongoing nature of the adviser-client relationship.[2]

3.3 As a result of this unique fee structure, some retail clients may be paying ongoing fees, while receiving little or no service/financial advice. Moreover, some clients may be unaware of the magnitude of the fees (perhaps due to disengagement), or the various other commissions and fees their advisers are being paid by product providers.

3.4 Consequently, the opt-in and fee disclosure obligations contained in the first tranche of the Bills are designed to protect disengaged clients from paying ongoing fees while receiving little or no advice. For clients who are engaged, the opt-in (renewal) requirements will allow them to assess whether they are receiving value for money and to terminate the agreement if they are not satisfied.

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1 Corporations Amendment (Future of Financial Advice) Bill 2011.

2 Treasury, *Submission 22*, p. 5.

3.5 The provisions of the Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) provide that where an ongoing relationship exists between a retail client and a financial adviser, and the client is paying an ongoing fee for advice, financial advisers are required to issue two separate notices:

(a) A fee disclosure notice: the financial adviser will need to issue an annual fee disclosure statement outlining all fees and charges if a retail client will receive advice for a period longer than 12 months. These notices will need to outline all ongoing fees paid by the client for the previous 12 months and the forthcoming 12 months.

(a) A renewal notice: if a client is paying ongoing fees for a period longer than 24 months, the financial adviser must provide both an annual fee disclosure notice and a renewal notice every two years. If a client does not renew, or 'opt-in', within a 30 day period, the agreement between the client and the adviser is terminated

3.6 If the above obligations are not fulfilled, the client is not obligated to pay the ongoing fee past the relevant 12 or 24 month period.

3.7 If the client does not respond to the renewal notice, or decides not to renew within the appropriate timeframe, the ongoing agreement terminates.

3.8 A number of products are excluded from the opt-in and fee disclosure obligations:

- where a person is paying an adviser by instalments for advice that has already been provided before the arrangement is entered into (a payment plan);
- the ongoing payment of an insurance premium; and
- the ongoing payment of a product fee.[3]

Submitter's views

3.9 The committee received considerable evidence from industry members suggesting that the financial services sector will be adversely affected by the fee disclosure and opt-in provisions of the Bill.

3.10 Generally, industry participants argued that these measures were not in the original Parliamentary Joint Committee (PJC) recommendations[4] and that the requirements will be expensive and difficult to implement. The Association of Financial Advisers (AFA) argued that:

> The way to get FOFA back on track is reasonably simple. Both the industry and consumers will applaud measures that remove opt-in and strengthen the

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3 Treasury, *Submission 22*, p. 6.

4 For example, see Association of Financial Advisers (AFA), *Submission 66*, p.10; Financial Planning Association of Australia (FPA), *Submission 62*, p. 6.

> opt-out provisions, remove the annual fee disclosure statements and remove the ad hoc approach to insurance commission bands inside super for groups. It is important to note that none of these were part of the 2009 PJC report.[5]

3.11 Moreover, witnesses such as Mr Dante De Gori, General Manager of the Financial Planning Association, informed the committee that fee disclosure obligations were not raised during the consultation phase of the reforms:

> 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.[6]

3.12 Industry participants argued that the disclosure notice obligations will negate the objective of the FOFA reforms to make financial advice more accessible and affordable for retail clients. The Financial Services Council (FSC) recommended that:

> ...the new Fee Disclosure Statement be a prospective requirement and amended to provide retail client with a pertinent summary of the fees and services noting that retail clients already receive the disclosure this measure is attempting to address.[7]

3.13 The Joint Consumer Groups contested industry views and argued that the opt-in and fee disclosure obligations are necessary to ensure the transparency of the financial services industry and keep clients engaged with their financial advisers.[8]

Fee disclosure notices

3.14 Financial advice industry representatives raised a number of concerns with the FOFA Bills' annual fee disclosure requirement:

- the definition of ongoing fees;
- questions surrounding the benefits of collating already existing information;
- a likely increase in the cost of seeking advice;
- the lack of time to implement the new requirements;
- the lack of consultation;
- the potential for an increase in litigation and complaints by consumers; and

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

6 Mr Dante De Gori, General Manager, Financial Planning Association *Committee Hansard*, 23 January 2012, p. 44. 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, *Committee Hansard*, 23 January 2012, p. 71.

7 Financial Services Council, *Submission 58*, p. 5.

8 Joint Consumer Groups, *Submission 25*, p. 2.

- the possible retrospective application of fee disclosure requirements.

Issues raised

3.15 The committee received evidence suggesting that the definition of ongoing fees is too broad and should be limited to 'financial product advice', not to the more encompassing 'financial services' as is currently drafted. The Stockbrokers Association argued that the Bill will limit the advice that financial advisers could issue to their clients, particularly in relation to more educational information, which is also captured by the current wording.[9]

3.16 The Stockbrokers Association also argued that the reasonableness of the fees ought to be examined as opposed to their ongoing nature.

3.17 In relation to the disclosure of fees, Burrell Stockbroking and Superannuation argued that financial advisers and product providers already comply with a high standard of fee disclosure.[10] For example, industry members who provide managed discretionary accounts are required to comply with disclosure requirements under the Corporations Act.

3.18 IOOF Holdings Limited detailed for the committee the number of disclosure documents it issues to its retail clients:

> In customer-centric businesses where clients are receiving appropriate service and disclosure, the opt-in requirements would add an unnecessary layer of administration and costs. Clients are already advised of fees and charges at various points/stages of the advice process. For example, advised clients would typically receive a copy of a Financial Services Guide, Terms of Engagement, Statement of Advice, Authority to Proceed and product statements as a minimum.[11]

3.19 Submitters also argued that the reporting date for these reports is 30 June each year and are concerned that compliance with the new provisions will mandate numerous compliance dates. They suggest that it would be more efficient to legislate a standard fee disclosure date, as opposed to having many 'disclosure days' throughout the year.[12]

3.20 In terms of labour and other costs associated with compliance, Burrell Stockbroking and Superannuation argued that the data simply does not exist to enable

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9 Stockbrokers Association of Australia, *Submission 8*, p. 9; Burrell Stockbroking and Superannuation, *Submission 11*, p. 2.

10 Burrell Stockbroking and Superannuation, *Submission 11*, p. 5; Professional Investment Services, *Submission 17*, p. 3.

11 IOOF, *Submission 19*, p. 5.

12 Burrell Stockbroking and Superannuation, *Submission 11*, p. 5; Professional Investment Services, *Submission 17*, p. 3.

industry members to comply with the legislation. It argued that it would be costly to install and implement new systems and that these costs will be passed on to clients:

> The issue is once again that Burrell Stockbroking and Superannuation and the industry in general do not have the systems in place to comply with the disclosure requirements. We agree with the general sentiment across the industry that the 'data does not exist' in order to be able to comply with the standard of disclosure expected. The cost of installing and implementing the systems to provide the required disclosure information will be a significant burden on our business and increase the cost of advice and services provided. Further, a major issue is that the information required to calculate these costs would be contained across various platforms which will not always be under our control. It is our opinion that the Committee needs to reconsider their costing analysis, and this needs to be reflected in the legislation.[13]

3.21 In relation to the practice of issuing multiple fee disclosure notices, the Financial Planning Association argued that the new annual fee disclosure statements represent:

> ...a fundamental shift in the way in which the law would be fabricated, because the current obligation is a product obligation. It rests with the product provider. If you use the example of a superannuation fund where the superannuation fund itself believes it has a relationship—a direct relationship, not through an adviser—with that member, the proposal would be that the adviser who might be advising the client on everything else concerning the relationship of financial products needs to somehow insert themselves into this product chain and communication and, by the way, often when the product provider may not want them to because the product provider feels they have a direct relationship. Now they have to send documents across to multiple parties. It has to be collated differently. There is a way of coding material so that it is the same so that it calculates in the same way—all this stuff that, frankly, has not been contemplated much in the industry. I think this is a real challenge. It is not just a simple matter of collating 22 pieces of paper.[14]

3.22 Given these issues, witnesses argued that more time was required to implement the necessary systemic changes to equip advisers and enable them to collate the various pieces of information into one coherent fee disclosure statement.[15]

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13 Burrell Stockbroking and Superannuation, *Submission 11*, p. 5. See also Associated Advisory Practices, *Submission 20*, p. 4.

14 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 43.

15 See for example, Mr Barrett, ANZ Wealth, *Committee Hansard*, 24 January 2012, p. 5; Mrs Keddie Waller, Policy Adviser, Financial Planning, CPA Australia, *Committee Hansard*, 24 January 2012, p. 51.

3.23 Moreover, it was put to the committee that the collation of fees is not the only difficulty. Witnesses argued that detailing each financial product will also add to costs, making financial advice more expensive. The AFA told the committee that:

> **...**the obligation is not just around providing information on costs. You have got to provide information on services actually provided, services that should have been provided in the last year, services that will be provided and should be provided in the next 12 months. So this is not simply a matter of consolidating costs from different product providers, which in itself would be an administrative effort across a client base of 300.[16]

3.24 The FSC estimated that the implementation of the fee disclosure requirements will be approximately $54 per client prospectively (for new clients) and $98 per client retrospectively (for existing clients).[17]

3.25 The absence of draft regulations and the lack of clarity in the Bills were also raised by witnesses. The Financial Services Ombudsman (FOS), for example, argued that subsection 962F(3) is problematic and could disadvantage consumers.[18] FOS believed that the provisions rendering the refund of fees discretionary will result in an increase in the number of disputes relating to fee refunds, which is already one of the most common areas of complaint.[19]

3.26 Accordingly, FOS argued the need to amend this section so as to better reflect the intent of the FOFA reforms. FOS believed that the Bill prevents clients from seeking refunds where there has been a miscommunication and/or forms have not been returned.[20] It claimed that this is not a fair outcome for consumers and noted that should an amendment not be made, there will be no recourse for consumers and FOS will not be able to assist. Instead, claims will need to be presented in court,[21] providing a significant disincentive to consumers to seek compensation for incurring charges while receiving no advice.[22]

3.27 It was also put to the committee that fee disclosure obligations should be prospective, not retrospective. Submitters raised concerns that the retrospective application of these obligations would be administratively difficult and expensive, particularly in respect to financial products that predate computers.[23]

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16 Mr Philip Anderson, Chief Operating Officer, Association of Financial Advisers Ltd, *Committee Hansard*, 23 January 2012, p. 17.

17 Financial Services Council, *Submission 58*, p. 7; *Committee Hansard*, 23 January 2012, p. 37.

18 Financial Services Ombudsman, *Submission 15*, p. 5.

19 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service (FOS), *Committee Hansard*, 24 January 2012, pp 41–44.

20 Mr Shane Tregillis, FOS, Chief Ombudsman, *Committee Hansard*, 24 January 2012, pp 39–48.

21 Mr Shane Tregillis, FOS, Chief Ombudsman, *Committee Hansard*, 24 January 2012, p. 44.

22 Mr Shane Tregillis, FOS, Chief Ombudsman, *Committee Hansard*, 24 January 2012, pp 39–48.

23 Professional Investment Services, *Submission 17*, p. 6.

3.28 The committee notes that there is uncertainty as to the 'retrospectivity' of the Bill. This uncertainty stems from the obligation that all clients (existing and new) must be sent a fee disclosure notice on the 12 month anniversary of their agreement. The Explanatory Memorandum (EM) states that this notice must contain the fees charged for the previous 12 months and the fees that will be charged for the forthcoming 12 months.[24] However, in relation to existing clients, the time period that needs to be included in the notices remains ambiguous.

3.29 Consequently, the committee sought clarification from Treasury. On notice, Treasury was asked:

> ...if a client entered into a relationship with an adviser on 21 July 2011, does this adviser then need to issue a disclosure notice on 21 July 2012, or the 12 month anniversary of the introduction of the legislation on 1 July 2013?
>
> If the answer is the 12 month anniversary of the contract, does the fee notice need to include all fees for the entire previous 12 month period, or is it only applicable to fees charged from the date the legislation takes effect? Using the above example, would the fee disclosure statement only include the fees charged for the period between 1 and 21 July, 2012?[25]

3.30 In response, Treasury informed the committee that:

> Under the provisions in the Bill, fee recipients of existing clients will need to disclose fee and service information for the prior 12 months, even where such information relates to a period before the FOFA reforms came into effect.[26]

3.31 Therefore, to return to the above example (paragraph 3.29), if a client entered into a relationship with an adviser on 21 July 2011, the financial adviser will have to issue a fee disclosure statement on 21 July 2012 (or within the specified 30 day disclosure period), detailing all fees charged for the 12 month period from 21 July 2011 until 21 July 2012, and for the forthcoming 12 months, ending 21 July 2013.

3.32 Some submitters have also expressed concern at the lack of consultation regarding the potential retrospectivity of the fee disclosure obligations. This issue is discussed in chapter 10.

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24 Corporations Amendment (Future of Financial Advice) Bill 2011, *Explanatory Memorandum*, para. 1.20 & 1.21.

25 Treasury, answer to question on notice, 24 January 2012, (received 10 February 2012). http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/future_fin_advice/submissions.htm (Accessed 24 January 2012).

26 Treasury, answer to question on notice, 24 January 2012, (received 10 February 2012). http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/future_fin_advice/submissions.htm (Accessed 24 January 2012).

3.33 Finally, the Joint Accounting Bodies raised concerns over the requirement to list 'anticipated services' on the fee disclosure notices. At the hearing, Mrs Keddie Waller of CPA Australia informed the committee that the word 'anticipated' allows for too much subjectivity:

> We would say it is too subjective. We would have to try and anticipate the services we are going to provide, as opposed to telling them what we propose to provide and then trying to anticipate on top of that what we will provide. It is too subjective and it is not adding value.[27]

The opt-in provision

3.34 Industry members expressed a number of concerns with the opt-in obligations. These include:

- the consequences should a client neglect to return their forms;
- an increase in the cost of providing advice;
- its necessity, given that clients already have the option to opt-out at any time; and
- the potential for confusion when clients have more than one renewal notice and more than one set of fees being withdrawn from their accounts.

Issues

3.35 A principal concern with the opt-in provision is in cases where a client simply forgets to fill out and/or return their form on time.[28] The committee was told that this is possible where a client is away on holidays or unaware of the renewal notice for any other reason, or neglects to return their forms and a significant financial event occurs that requires action by an adviser. Some witnesses noted that if a relationship is unwittingly terminated, there may be severe financial repercussions for retail clients. The National President of the AFA told the committee:

> Some clients just like the peace of mind of knowing that there is a person they know, understand and have a relationship with to ring when they want advice. They do not necessarily want the annual review. They are happy to pay along the way. I will give you an example of an aged client of ours who is down to his last $35,000 in super. He is in his 80s. He does not want to review his risk profile. He does not want all the other things to help him with his Centrelink, but he did want to talk to me about getting the last ever brand-new car that he is going to get. We withdrew the money and bought him a new car. I earn $14 a year from that client...

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27 Mrs Keddie Waller, Policy Adviser, Financial Planning, CPA Australia, *Committee Hansard*, 24 January 2012, p. 51.

28 This issue was raised by Burrell Stockbroking and Superannuation, *Submission 11*, p. 5; Financial Services Ombudsman, *Submission 15*, p. 2; Professional Investment Services, *Submission 17*, p. 5.

> But the issue there is getting someone in their 80s to return the paperwork or getting a busy executive or just someone who is flat-out raising two or three kids to remember to put their signature on the paper and send it back instead of putting it in the bin. Then there is the follow-up and the wife says to the husband, 'Do you know about this?' 'No, I'm not sure. Haven't you got it?' Time ticks along. There are people away, travelling the country in their retirement, who do not get the notice until they get back from their travels and meanwhile they have been ex-communicated from their advice relationship. What do we do then?[29]

'Opt out' option

3.36 Evidence was presented to the committee demonstrating that clients already have the option to opt-out of contracts with their financial planner at any time.[30] Professional Investment Services argued that the opt-in obligations are superfluous and merely create another level of bureaucracy:

> 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.[31]

3.37 Burrell Stockbroking and Superannuation argued that an opt-out approach would be more appropriate than an opt-in obligation:

> Burrell Stockbroking and Superannuation and the industry in general already allow clients the ability to opt-out at any stage or by complying with a short notice period (our Firm currently requires one month's written notice). We, like many in the industry, believe that opt-in should be removed from the Bill. Alternatively, at the least, opt-out should be adopted. Opt-out provides clients with safeguards while allowing the financial industry to focus on clients and not complying with over burdensome regulatory conditions.[32]

3.38 Associated Advisory Practices argued that additional costs resulting from the opt-in requirement will have to be borne by the consumer:

> Should the client be simply a few days late in responding, this would imply that the adviser and client would need to agree to a totally new fee arrangement, which in reality could only be done by providing a new Statement of Advice. This is a very significant cost and imposition for a late response.[33]

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29 Mr Bradley Fox, National President, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 19.

30 IOOF, *Submission 19*, p. 5.

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

32 Burrell Stockbroking and Superannuation, *Submission 11*, p. 4.

33 Associated Advisory Practices, *Submission 20*, p. 3.

Cost estimates

3.39 The committee draws attention to the large discrepancies in estimates of the cost of fee disclosure and opt-in requirements. For example, during the hearings, the committee was advised of a number of different figures by witnesses.

3.40 As cited in the EM and the Regulations Impact Statement, Rice Warner Actuaries estimated that the cost of the opt-in requirements would be $11 per client.[34] Burrell Stockbroking and Superannuation dispute this figure, estimating the cost of compliance to be much higher:

> If the legislature believe that all opt-in will require is sending a notice to clients they are mistaken. Opt-in will require meeting with the client to renegotiate contracts and costs. We calculate the time of such a meeting, including preparation, to be more than two hours. As such, the cost of opt-in per client will be around $650 per client. Further, even in the unlikely event that a meeting is not conducted the cost of compliance with opt-in alone would be between $50 and $100. The cost of opt-in is likely to push many independent financial advisers out of the industry. This will lead to less independent advice which is counterintuitive to the Bill's aims.[35]

3.41 The AFA estimated the cost of compliance with the fee disclosure and opt-in obligations to be somewhere between $100 and $120 per client:

> One of the misnomers is that it is going to be simple: our product provider is going to give us the summary and we are just going to post it out to the client. I am not in my business—and many advisers are not—linked to using just one product provider. So, if I want to give that to a client, I may need to get it across some direct investments they hold, perhaps a life imputation bond they hold, perhaps a superannuation policy, perhaps some risk cover. They may all be with different providers. I need to get that information from all providers and bring it to one statement. Our estimate is that it will take three-hours per client over a two-year cycle. If you put an average administration worker's cost against that—perhaps $35 to $40 an hour—we are talking between $100 and $120 to the client.[36]

3.42 The FSC posited a different figure:

> **Senator CORMANN:** Quickly going back to the annual fee disclosure requirements, you mentioned in your submission that it would cost around

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34 Rice Warner's submission to the government citing figures is available at: http://www.ricewarner.com/images/newsroom/1316044106_The%20Cost%20of%20Opt-in_Government%20Submission.pdf. The full report is available at: http://www.industrysupernetwork.com/wp-content/uploads/2011/05/OptInRiceWarner.pdf. The Rice Warner research was commissioned by the Industry Super Network.

35 Burrell Stockbroking and Superannuation, *Submission 11*, p. 2

36 Mr Bradley Fox, National President, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 16.

> $54 per client prospectively and $98 per client retrospectively. Is that going to be a cost that will be passed on as such to the clients?
>
> **Ms Storniolo:** That is the opt-in cost, yes?[37]

3.43 Mr Mark Rantall, Chief Executive Officer of the Financial Planning Association, sought to explain these discrepancies to the committee:

> The reality is every practice operates in a different way... So the costing models of all of those groups are individual, because they are basically a small business in private business and private practice. The numbers we can put a foot on, if you like, are these. The investment trends survey, which was an independent survey of advisers, put the cost of opt-in at $132. Conservatively, if you look at 16,000 financial planners looking after an estimated 300 clients each, that comes out to a number of $317 million across the industry per annum. Then if you take the cost of the annual disclosure statement which we talked about before, our members tell us that on average that will cost them $113 per client and, again, on the same basis of 300 clients per average and 16,000 financial planners in the country, that comes to a figure of $542 million. We heard this morning figures around the $750 million on the basis of implementation, and ongoing costs of $350 million. Our figures are coming in around those same sorts of figures, so there is not a huge discrepancy...
>
> I think that the Rice Warner $11 was purely on an opt-in, whereas our research is in respect of a number of the FOFA reforms, in particular those two areas...The reality is that no independent impact statement has been done on the cost of this to either participants or consumers, and that is the heart of the matter for this issue.[38]

The need for an opt-in provision

3.44 Another issue raised by submitters was the relevancy of the opt-in obligations. Some submitters argued that the requirement to opt-in is made redundant by the application of the best interests test, the fee disclosure notices and the already existing ability to opt-out at any time. The Financial Planning Association told the committee:

> Therefore, considering that the renewal notice provisions will only apply to new clients coupled with the banning of commissions (including trail) and the introduction of a best interest duty, the FPA strongly believes that opt-in is a redundant policy.[39]

3.45 Mr Craig Meller, Managing Director, AMP Financial Services, also addressed the issue of relevance:

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37 Ms Cecilia Storniolo, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 37.

38 *Committee Hansard*, 23 January 2012, p. 42.

39 FPA, *Submission 62*, p. 6.

> 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.[40]

3.46 Dr Deen Sanders, Chief Professional Officer of the Financial Planning Association, highlighted the potential for client confusion. He argued that some clients may become confused as to who is withdrawing fees for ongoing services:

> Arguably, there might even be an increasing liability, which is partially our concern as well. A client may cease to engage in the opt-in arrangement with one of those advisers, but the other one might be a commissioned adviser or there might be some sort of legacy structure, and they think they are still paying a commission somewhere, because they get a statement that says that, but it is not actually from the professional adviser that they think they have the relationship with. There is enormous complexity.[41]

3.47 Burrell Stockbroking and Superannuation argued that the Bill should ensure that fees represent value for money. It asserted that targeting on-going fees through the opt-in provisions does not achieve this outcome:

> The focus of the Bill should be on whether fees are reasonable, not the ongoing nature of the fees. In most instances ongoing fees in relation to advisory services provide clients with value for money. By discriminating against ongoing fees Burrell Stockbroking believes the opt-in provisions will not have the desired effect of ensuring clients obtain the best outcome. Opt-in will disengage clients and discourage business models that are value for money. It is Burrell Stockbroking and Superannuation’s opinion that opt-in should be removed from the Bill, or at the least the legislature should adopt an opt-out policy.[42]

3.48 It was put to the committee that the expectations of clients need to be clearly articulated on opt-in notices and that there needs to be clear regulations stipulating the expectations that ought to be included on the renewal forms.[43]

Committee view

3.49 The committee acknowledges the various views presented. Above all, however, on the annual fee disclosure requirement and opt-in obligation, the

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40 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 5.

41 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 46.

42 Burrell Stockbroking and Superannuation, *Submission 11*, p. 3.

43 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service, *Committee Hansard*, 24 January 2012, pp 43–44.

committee emphasises that the fee disclosure provisions and the opt-in obligation will make financial advice more transparent.

3.50 As Treasury explained:

> The concept of compulsory renewal of ongoing advice fees, requiring the active renewal by the client to ongoing fees, is designed to protect disengaged clients from paying ongoing financial advice fees where they are receiving little or no service. For those clients that are not disengaged, the renewal requirement will provide them with an opportunity to consider whether the service they are receiving equates to value for money.[44]

3.51 Essentially, the proposed legislation seeks to impose obligations to have an appropriate level of communication between financial advisers and retail clients. This will help ensure that clients remain engaged with the financial services they are paying for, thereby helping to protect retail clients from dishonest financial practices.

3.52 The committee considers that both the opt-in and annual fee disclosure obligations will help to engage clients and allow for more transparent communication between financial advisers and their retail clients. Associate Professor Joanna Bird explains that:

> ...the renewal notice—or the opt-in, as it is called—is crucial to the protection of disengaged clients...[W]ithout this reform there is great danger that industry will replicate all the negative features of the existing commission system through the use of non-transparent, ongoing, asset based fees...
>
> The problem is that even with the best-interests duty and even with the ban on commissions and other forms of conflicted remuneration it will still be possible for advisers to charge asset based fees on an ongoing basis. Those fees will operate much like commissions. In other words, if I enter into that sort of relationship I will have a certain percentage taken out of my funds under advice every year, on an ongoing basis, possibly indefinitely.
>
> Without the opt-in and without the fee disclosure notice, it is possible I will not realise that is happening, I will not know that is happening and I will not have made an informed decision for it to happen, and I certainly will not have made an informed decision for it to happen on an ongoing basis. We see the opt-in as crucial to protecting disengaged clients who get into the position of paying fees without realising that they are doing so. We see the fee disclosure statement as essential for that large group of clients who will not get the opt-in. Basically, we do not see any reason why you should not actually get a statement from your professional adviser on a yearly basis setting out the fees they are charging you.[45]

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44 Treasury, *Submission 22*, p. 5.

45 Assoc. Prof. Joanna Bird, representing the Australian Shareholders' Association, the Australian Investors Association, Choice, Consumer Action Law Centre, Council on the Ageing and the National Information Centre on Retirement Investments, *Committee Hansard*, 23 January 2012, pp 57–58.

3.53 The committee agrees with the Joint Consumer Groups, who argue that:

> The fee disclosure statement ensures that clients are aware of the ongoing fees they are paying and the services they receive in return for those fees. This information enables clients to make an informed decision about whether they want to continue paying those fees. Importantly, the fee disclosure statement gives clients information that they do not receive from current financial services disclosure documents.[46]

3.54 In terms of the opt-in provisions, the committee supports the comments made by the Joint Consumer Groups, who informed the committee that:

> The renewal notice requirement ensures that disengaged retail clients do not pay ongoing fees for little or no service. Current remuneration models in the financial advice industry mean that clients often pay for advice on an ongoing basis (that is, indefinitely until they take an active step to stop payment) in a manner which requires them to take no active steps to effect payment. That is, payment is not transparent to the clients. Disengaged clients are very vulnerable to exploitation through such remuneration models. The renewal notice requirement will force clients to take an active step once every two years.[47]

3.55 The committee disagrees with the view that adequate fee disclosure is already provided to clients by financial advisers and product providers. The fee disclosure statements that are currently issued are disparate and fragmented. As witnesses highlighted during the hearings, clients may have purchased up to eight or more products. Currently, these clients would receive statements from each product provider and from their financial adviser at different times throughout the year. This information is highly fragmented and the committee believes that most retail clients would not have the time or the capacity to collate this information. Associate Professor Joanna Bird provided these comments:

> If a client had 18 products, I would have to sit there and collate the 18 products. The periodic statements will come in at different times. I am going to have to collate them all to figure out what I am paying my adviser...[48]
>
> The periodic statements that I get are lengthy and complex. And actually it would be a task that would be beyond most consumers to go through those and collate the information that you are talking about.[49]

3.56 Therefore, the fee disclosure notices are an important and simple source of information for clients, which details in a clear and succinct format the fees and charges they are paying for financial advice.

46 Joint Consumer Groups, *Submission 25*, p. 2.

47 Joint Consumer Groups, *Submission 25*, p. 2.

48 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 60.

49 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 61.

3.57 Moreover, the committee believes that the opt-in obligation empowers the less-financially literate clients to say 'no' and encourages them to think about the services they are receiving and the fees they are being charged for those services. Provided that renewal notices are clear and concise, the potential for false expectations on behalf of both retail clients and financial advisers will be minimised.

3.58 It was also put to the committee that clients already have the option to opt-out at any time and that the opt-in provisions are a waste of time and money. However, the committee believes that this ability does not negate the need for the opt-in obligations because many customers do not know they have this option, or are disengaged. By ensuring that they regularly review their contracts, clients are prompted to remain engaged and aware of the services they are/are not receiving.

3.59 It was put to the committee that the 'best interest' test will negate the need for fee disclosure and opt-in notices (see paras 3.44–3.45). However, the committee does not regard the best interest obligations as sufficient for the provision of information to the client and for assisting client engagement. The best interest test is there to assist financial advisers to recommend the best product for their clients, not for helping clients evaluate whether or not they are receiving value for money.

3.60 With this in mind, the committee acknowledges that there is room for clarification in the provisions. Clients and advisers need to be clear as to what is expected of them in the relationship and advisers need to be transparent about the fees they are charging. As such, the committee believes that FOFA regulations need to provide clarification in regards to the minimum information that is required in the fee disclosure and the opt-in notices.

3.61 Moreover, the committee believes that the EM should be amended to provide clear guidance as to when annual fee disclosure notices need to be provided to existing clients. The Consumer Groups raised this issue with the committee:

> We agree that the legislation needs to be clarified as to when the fee disclosure statement would first be required for existing clients. That bit is unclear.[50]

3.62 The provisions relating to subsection 962F(3) should be revised. In particular, the provision stating that a fee recipient is not obliged to refund money where there is a failure to comply with the renewal obligation by the fee recipient.

3.63 The committee agrees with FOS and believes there could be unintended consequences for retail clients by restricting their access to recourse and/or arbitration. It also appears to provide a disincentive for financial advisers to follow up clients. If a client does not respond to a renewal notice, and continues to pay a fee for no service, the problem that FOFA is seeking to address continues. Moreover, another difficulty

50 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 61.

for customers is added: financial providers are not obligated to refund this money. This does not appear to be consistent with the intent of FOFA.

Recommendation 1

3.64 The committee recommends that subsection 962F(3) of the Corporations Amendment (Future of Financial Advice) Bill 2011 be reviewed with a view to providing access to recourse for consumers who have had fees wrongfully deducted.

Recommendation 2

3.65 The committee recommends that 'minimum disclosure' guidelines be included in the regulations of the Corporations Amendment (Future of Financial Advice) Bill 2011 for fee disclosure and opt-in notices, stipulating a standard for communication between financial advisers and their retail clients.

Recommendation 3

3.66 The committee recommends that the Explanatory Memorandum to the Corporations Amendment (Future of Financial Advice) Bill 2011 be amended to better explain the annual fee disclosure obligations for existing retail clients.

Chapter 4

Views on the introduction of a statutory 'best interests' duty for financial advisers

4.1 One of the central recommendations of this committee's 2009 report, *Inquiry into financial products and services in Australia*, was the introduction of a statutory fiduciary duty for financial advisers to act in the best interests of their clients. This measure has been supported by government since the initial FOFA reform announcement in April 2010, and is being introduced in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 as outlined in chapter 2.

Support for a statutory 'best interests' duty for financial advisers

4.2 The evidence received by the committee in its 2009 inquiry highlighted the clear need for a statutory fiduciary obligation for financial advisers to act in the best interest of their clients. This has also been confirmed by evidence presented to the committee during its ongoing inquiry into the collapse of Trio Capital. The committee is currently preparing its report for this inquiry, and the cumulative weight of evidence from the committee's 2009 inquiry, the Trio inquiry and the current inquiry into the FOFA legislation, make an overwhelming case for the introduction of a statutory best interests duty.

4.3 During the current inquiry, the committee received evidence that stakeholders are supportive of the introduction of a statutory duty for advisers to act in the best interests of their clients. The support for this measure included support from industry peak bodies, consumer groups, accounting bodies as well as Treasury and ASIC,[1] and was well summarised by the Joint Accounting Bodies:

> The Joint Accounting Bodies believe the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory best interests obligation will embed this motivation in the financial advice framework to ensure all financial planners make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates. We believe introducing this obligation will improve the public’s trust and confidence in the advice they receive.[2]

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1 Association of Financial Advisers Ltd, *Submission 66*, p. 12; Financial Services Council, *Submission 58*, p. 41; Financial Planning Association of Australia, *Submission 62*, p. 16; Joint Accounting Bodies, *Supplementary submission 23*, p. 3; Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 57; ASIC, *Supplementary submission 28*, p. 12; Treasury, *Supplementary Submission 22*, p. 3.

2 Joint Accounting Bodies, *Supplementary submission 23*, p. 1.

4.4 The committee heard that many parts of the financial advice industry already adhere to a 'client's best interests' standard of advice. The Association of Financial Advisers (AFA) currently imposes a 'best interests' obligation on its members as part of its code of ethics, and the Financial Planning Association's (FPA) code of practice requires members to place the interests of clients ahead of their own.[3] The Boutique Financial Planning Principals Group (BFPPG) also noted that its members must act in their clients' best interests as a condition of membership.[4]

4.5 While the intent of the best interests provisions was therefore welcomed by the industry, numerous submitters made comment on the precise nature and scope of the duty contained in the Bill. This is discussed further below.

Formulation of the 'best interests' provisions

4.6 The 'best interests' obligation is formulated through several clauses in the second FOFA Bill. The Bill proposes to insert new Division 2 in Part 7.7A of the Corporations Act. This new Division contains all provisions relating to the 'best interests' duty.

4.7 The best interests obligations are divided into several components, including:

- a general duty that advisers must act in the best interest of their clients, supplemented by a series of steps advisers can take in order to meet this duty (subsections 961B(1) and 961B(2));
- a requirement that advice given by providers is appropriate to the client (section 961G); and
- a requirement that if there is a conflict between the interests of the client and those of the provider, licensee or authorised representative, the provider must give priority to the client's interests (section 961J).

4.8 The provisions of subsections 961B(1) and 961B(2), 'provider must act in the best interests of the client' are as follows:

> (1) The provider must act in the best interests of the client in relation to the advice.
>
> (2) The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:
>
> a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
>
> b) identified:

3 Association of Financial Advisers, 'AFA Code of Ethics', http://www.afa.asn.au/members_conduct_ethics.php (accessed 25 January 2012); Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 40.

4 Boutique Financial Planning Principals Group Inc., *Submission 48*, p. 4.

(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and

(ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the client's relevant circumstances);

c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;

d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;

e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:

(i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and

(ii) assessed the information gathered in the investigation;

f) based all judgements in advising the client on the client's relevant circumstances;

g) taken any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

4.9 Additionally, section 961H provides that if, after 'reasonable inquiries' have been made, information from the client is incomplete or inaccurate, the provider may still give advice, but must warn the client that the advice is based on incomplete or inaccurate information.

4.10 Proposed Subdivision F of Part 7.7A provides for the responsibilities of licensees in relation to the best interests duty. Licensees must ensure that their representatives comply with the best interests provisions, and that licensees which breach the best interests provisions are subject to civil penalties (sections 961K-961N). Subdivision G provides for the responsibilities of authorised representatives. Authorised representatives who contravene the best interests provisions are also subject to civil penalties (section 961Q).

4.11 Subdivision A provides that the best interests obligations apply only in relation to the provision of personal advice to retail clients (subsection 961(1)). This means that advisers providing general advice only will not be subject to the best interests obligations. The subdivision also includes a definition of 'provider' for the purposes of the section; namely, 'the individual who is to provide the advice' (subsection 961(2)).

Replacing current conduct obligations under section 945A and section 945B

4.12 The Bill repeals sections 945A and 945B of the Corporations Act, which deal with conduct obligations for financial advisers. As noted in chapter 1, section 945A of the Corporations Act requires that advisers providing personal advice must have a 'reasonable basis' for that advice, based on the relevant personal circumstances of the client and the adviser having conducted 'reasonable inquiries in relation to those personal circumstances' and the subject of advice. The Explanatory Memorandum (EM) to the Bill states that the requirement for advice to be appropriate to the client is retained in the new section 961G, and that the process-related elements involved in this requirement have been incorporated into the steps of the new best interests obligations found in subsection 961B(2).[5]

4.13 Additionally, the EM notes that section 961H, relating to providing advice in the event of incomplete or inaccurate information, is a replacement of similar provisions in section 945B.[6]

Views of submitters on the 'best interests' provisions in section 961B

4.14 Many submitters commented on the drafting and potential effect of the best interests provisions in section 961B. The issues raised included:

- whether or not the best interests provisions amount to a statutory fiduciary duty for advisers, as recommended by this committee's 2009 report;
- whether the 'reasonable steps' provisions in subsection 961B(2), particularly the inclusion of paragraph 961B(2)(g), make the duty unclear and unworkable for advisers to implement; and
- whether the best interests obligations will adequately facilitate the provision of limited or 'scaled' advice.

Fiduciary duty provisions

4.15 The committee's 2009 report on financial products and services in Australia recommended that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an Australian Financial Services License, requiring them to place their clients' interests ahead of their own.[7] The best interests provisions in the Bill are intended to directly implement this recommendation.[8]

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5 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 16–17.

6 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 17–18.

7 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, November 2009, p. 110.

8 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 6.

4.16 According to the EM, the Bill has taken the approach of setting out a general duty for advisers to act in the best interests of their clients, while also setting out a number of reasonable steps that may be taken as complying with that duty.[9] Some submitters argued, however, that this approach falls short of placing a fiduciary duty on advisers. For example, 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.[10]

4.17 Furthermore, the Trust Company submission argued that the prescriptive duty encompassed in subsection 961B(2) constitutes a duty of care rather than an explicit fiduciary duty:

> A duty of care is a requirement to meet a standard of reasonable care and skill when performing a service or providing a product. The standard is objective and based on what is expected of the "reasonable" person, service provider or manufacturer. A person can owe another person a duty of care without being subject to a duty of loyalty.
>
> ...
>
> 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.[11]

4.18 The Law Council of Australia agreed with this sentiment, stating that the steps in subsection 961B(2) 'strongly imply that an adviser's best interest duty under 961B has been mislabelled and is more akin to the adviser's duty of care at general law rather than their fiduciary duties'.[12]

4.19 The Industry Super Network (ISN) also commented on this issue, noting that the process steps outlined in subsection 961B(2) are atypical in a fiduciary-type duty and more similar to a duty of care.[13] ISN advocated that the drafting of the best interests duty should be 'along more traditional lines, which would have left it as the

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9 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 6.

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

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

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

13 Industry Super Network, *Supplementary submission 12*, p. 2.

principles-based duty contained in s961B(1)'.[14] The Australian Institute of Superannuation Trustees agreed that a broad, principles-based fiduciary duty would have been preferable to the prescriptive duty contained in the Bill.[15]

4.20 The Joint Consumer Groups commented that the description of section 961B as a best interests duty, when it is really a duty to exercise reasonable care and diligence, may cause uncertainty and unpredictability. It stated:

> ...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.[16]

'Reasonable steps' provisions of subsection 961B(2)

4.21 As outlined above, some stakeholders queried why the best interests duty has been formulated with both a general duty in subsection 961B(1) and the 'reasonable steps' provisions contained in paragraphs 961B(2)(a)-(g), rather than a more general best interests duty similar to that contained in the *Superannuation Supervision Act 1993* (SIS Act).[17] The EM to the Bill provides a rationale for this formulation. With regards to the process steps in subsection 961B(2), the EM states:

> These steps have been set out based on the specific conditions under which advisers currently operate. This approach is needed given the broad nature of a best interests obligation; it may allow a provider to demonstrate that it has complied with the obligation by providing it took certain steps.[18]

4.22 While the intent to provide a 'safe harbour' to help advisers discharge their duty was welcomed, some stakeholders expressed concern about the specific wording of the provisions contained in subsection 961B(2). For example, the Financial Services Council (FSC) expressed concern that the provisions in subsection 961B(2) are drafted in a way which places an unreasonable burden of proof on the adviser to prove that they have acted in the client's best interest. The FSC suggested that the provisions be drawn conversely, allowing an adviser to refute specific allegations that they have not acted in the client's best interest.[19]

4.23 In particular, the inclusion of paragraph 961B(2)(g) provoked much commentary from stakeholders. Paragraph 961B(2)(g) provides that having taken the steps outlined in 961B(2)(a)-(f), a provider must also have 'taken any other step that

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14 Industry Super Network, *Submission 12*, p. 2.

15 Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 3.

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

17 Section 52 of the SIS Act includes a statutory obligation for superannuation trustees to act in the best interest of fund members (see also paragraph 4.32 below).

18 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 9.

19 Financial Services Council, *Submission 58*, pp 43, 47–48.

would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances' in order to satisfy the best interests duty. Several stakeholders expressed concerns that this paragraph adds uncertainty for advisers trying to fulfil their best interests obligations, and that as a result, the reasonable steps provisions fall short of providing the 'safe harbour' envisaged in the government's initial policy announcements.[20] The Law Council of Australia argued:

> 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 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.[21]

4.24 Several stakeholders advocated the removal of paragraph 961B(2)(g) so as to achieve greater certainty regarding the operation of the proposed best interests duty.[22] AMP suggested that if paragraph (g) is not removed, that it should be amended to reflect the fact that the obligation is designed to be imposed at the time that advice is provided.[23]

4.25 Conversely, ISN expressed concern that the inclusion of reasonable steps provisions hinder the goal of raising standards in the industry, noting 'there is a significant risk that defining a professional duty through process will result in a "tick-a-box" mentality rather than shifting financial planning to a more professional culture'.[24]

4.26 Treasury officials indicated that the inclusion of paragraph 961B(2)(g) is designed to help avoid a "tick-a-box" attitude, and that paragraph (g) was not designed to be overly burdensome for advisers:

> In terms of interpretation, the problem we have ... is that if you take out (g) you are virtually going back to a tick a box type arrangement. With (g) it is taking any other step, so the provider satisfies the duty and take any other step that would reasonably be regarded as being in the best interest of the

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

21 Law Council of Australia, *Submission 55*, p. 4.

22 Financial Services Council, *Committee Hansard*, 23 January 2012, pp 33–34; AMP Financial Services, *Submission 43*, p. 16; Law Council of Australia, *Submission 55*, p. 4.

23 AMP Financial Services, *Submission 43*, pp 16–17.

24 Industry Super Network, *Submission 12*, p. 2.

> client given the client's relevant circumstances. So it is any other step reasonably regarded.
>
> ...
>
> Where the companies are worried, they say, 'We go through all these steps and then we give good advice, something does not work out and then we get sued over this.' I would have thought 'reasonably regarded as in the best given the client's relevant circumstances' pretty much does it.[25]

4.27 ASIC noted that other 'safe harbour' provisions in the Corporations Act are more rigorous than a "tick-a-box" approach, and achieve an increase in professionalism:

> ...I am aware from reading the submissions that there has been differing views on whether the last paragraph of that particular provision, paragraph (g), is appropriate or not and I think there is clearly a policy decision to be made about whether or not there is to be a tick-a-box approach in terms of how this defence is going to work or there is going to be something more substantive. I can only point to other provisions in the Corporations Act. For example, there is a safe harbour provision for directors' duties provisions and it is certainly not a tick-a-box approach. It requires people to assess things like they have made a judgment in good faith and for a proper purpose, they do not have a material personal interest, they have informed themselves about the subject matter of the judgment and they rationally believe the judgment is in the best interests of the corporation.[26]

4.28 ASIC also commented that it believed the safe harbour provisions are adequate and that they meet the policy objective:

> I think the question is: what policy result do you want to achieve? That is really a matter for government. The stark choice I am drawing is whether or not you want a tick-a-box approach, which you really get very close to if the provision in (g) is removed, or whether you want to transform this into a profession and have people exercising particular judgment in particular cases as other professionals do.[27]

4.29 ASIC also noted that paragraph 961B(2)(g) adds flexibility to the reasonable steps provisions that may be useful in administering the legislation:

> I might just add that there is a balance to be struck in any of these types of provisions between providing people with certainty but also providing some flexibility about how things are administered. If you were to remove (g), you would remove effectively the flexibility. My experience with these

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25 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 64.

26 Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, pp 69–70.

27 Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, pp 69–70.

> sorts of reforms is that often industry actually wants both—they want some certainty but also some flexibility. That is I think an appropriate way to approach that. As Mr Price has indicated, this sort of approach, where you have a list of particular issues that must be dealt with plus a provision that allows for other matters that might arise from time to time or might be considered, is not unusual in other parts of the law that ASIC itself administers. We have some experience with these sorts of issues.[28]

Interaction with other general law and statutory duties

4.30 The Law Council of Australia expressed concern that the formulation of the best interests duty in subsection 961B(1) does not accord with either the general law fiduciary duty to act in the best interests of their client, or other existing statutory best interests duties; namely, those for superannuation trustees and for the responsible entities and directors of managed investment schemes.[29]

4.31 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.[30]

4.32 Westpac Group argued that to avoid advisers being subject to both general law duties and the new statutory duty, the legislation should make it clear that compliance with the best interests obligation will be deemed compliance with the general law obligations.[31]

4.33 The Law Council of Australia noted that in addition to general law duties, superannuation trustees providing personal advice are subject to obligations under the SIS Act which obligates trustees to perform their duties in the best interests of members.[32] The Law Council contended that there may be situations where the new best interests duty under section 961B conflicts with trustees' existing duty under the SIS Act; the SIS Act requires trustees to act in the best interests of fund members as a whole, whereas the new duty requires trustees to act in the best interests of the individual member being provided advice. For example, if personal advice was given

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28 Mr Peter Kell, Commissioner, ASIC, *Committee Hansard*, 24 January 2012, p. 70.

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

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

31 Westpac Group, *Submission 64*, p. 13.

32 Law Council of Australia, *Submission 55*, pp 4–5. The existing best interest obligations for superannuation trustees are contained in *Superannuation Supervision Act 1993*, paragraph 52(2)(c).

that a member should switch out of the superannuation fund (with the adviser having deemed that this is in the client's best interest), the result of this advice may be detrimental to fund members as a whole due to reduced economies of scale.[33]

Regulations may alter the best interests obligations

4.34 Subsection 961B(5) of the Bill provides that regulations may be made to add or substitute steps to those outlined in subsection 961B(2) in prescribed circumstances. The regulations may also outline that certain steps in subsection 961B(2) do not apply to providers in certain circumstances, or outline circumstances in which the general duty in subsection 961B(1) does not apply. The EM explains the rationale for including these provisions in the Bill as follows:

> It is important for there to be a degree of flexibility around the more detailed aspects of the best interests obligation because of the diversity and complexity of the financial services industry.
>
> This regulation-making power will allow the legislation to be updated in a timely manner in the event that the application of a particular step (or steps) is found to result in undesirable consequences in the light of advancements in the financial services industry or the provision of advice in unique and unforseen circumstances.[34]

4.35 The Senate Standing Committee for the Scrutiny of Bills noted in its *Alert Digest No.1 of 2012* that these provisions allow the central elements of a statutory obligation to be dealt with by regulations rather than primary legislation, and suggested that the Senate consider whether this delegation of legislative power is appropriate.[35]

Concerns about increasing professional indemnity insurance premiums

4.36 Professional Investment Services claimed that the increased obligations on advisers under the new best interests provisions will increase the cost of advisers obtaining professional indemnity insurance, a cost which would be ultimately borne by consumers.[36] The Financial Services Council agreed, warning:

> 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

33 Law Council of Australia, *Submission 55*, p. 5.

34 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 16.

35 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 1 of 2012*, 8 February 2012, pp 7–8.

36 Professional Investment Services, *Supplementary submission 17*, p. 7.

> remain high (higher than current costs) thereby increasing the cost of advice for Australians without any commensurate consumer protection.[37]

Ability for advisers to provide scaled advice under the new duty

4.37 One of the stated aims of the FOFA reform package is to increase the availability of limited or 'scaled' financial advice to consumers. Scaled advice is currently permissible under section 945A of the Corporations Act. The stated intention of the new best interests obligations is to continue and expand access to scaled advice. As explained by Treasury:

> The steps [in subsection 961B(2)] are designed to facilitate the provision of 'scaled advice' which is advice about one issue, or a limited range of issues (as opposed to 'holistic' advice that looks at all aspects of the client's financial circumstances). As long as the provider acts reasonably and bases the decision to narrow the subject matter of the advice on the interests of the client, they will not be in breach of their obligation to act in the client's best interests.[38]

4.38 The government has expressed a clear commitment to facilitating the provision of scaled advice, and particularly limited advice provided by superannuation funds to their members. This is known as 'intra-fund' advice. Announcing new rules for the provision of intra-fund advice in December 2011, the Minister for Financial Services and Superannuation, the Hon Bill Shorten MP, stated:

> The delivery of scaled advice is critical to achieving the Government's objectives of promoting greater access to financial advice. This Government is committed to providing advisers with certainty of how to provide this form of advice in a way that meets their regulatory obligations.[39]

4.39 The provision of intra-fund advice by superannuation funds is currently allowed under an ASIC Class Order, which exempts funds providing intra-fund advice from any requirements in section 945A of the Corporations Act.[40] This Class Order is supplemented by an ASIC Regulatory Guide which provides further guidance about how trustees can provide intra-fund advice.[41]

4.40 Despite the clear policy intent to facilitate access to scaled advice, some submitters to this inquiry contended that the current drafting of the best interest provisions does not provide comfort for financial advisers seeking to provide scaled

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37 Financial Services Council, *Submission 58*, p. 41.

38 Treasury, *Supplementary submission 22*, p. 4.

39 The Hon Bill Shorten MP, Minister for Financial Services and Superannuation, 'Improving access to simple financial advice', *Media Release No. 164*, 8 December 2011.

40 ASIC Class Order CO 09/210, *Intra-fund superannuation advice*, July 2009.

41 ASIC Regulatory Guide 200, *Advice to super fund members*, July 2009.

advice.[42] In order for scaled advice to occur, advisers must be able to effectively limit the scope of the advice provided to a client while still fulfilling their obligation to act in the client's best interests. However, the committee heard that current drafting of the 'reasonable steps' provisions in subsection 961B(2) may not allow advisers to do this. In particular, paragraph 961B(2)(b) requires providers to identify:

> (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
>
> (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the ***client's relevant circumstances***).

4.41 The EM notes that identifying the subject matter of advice sought could be a simple process, but that:

> [1.33] in some cases, particularly where the client has complex needs or objectives, it is recognised that clients may not be immediately able to identify the subject matter of the advice they are seeking. In these situations, it may be necessary for the provider to enter into a discussion with the client about what subject matter of advice would be in their best interests. This can take into account considerations like how much the client is willing to spend on the advice. However, the provider cannot enter into a contract to be exempted from this obligation merely by seeking formal agreement from the client that the subject matter of the advice that has been given by the provider is what has been requested by the client and is therefore in the client’s best interests. In identifying the advice that has in effect been sought by the client (including advice implicitly sought by the client), the provider must take into account the client's overall circumstances.[43]

4.42 The EM further states that this process of identifying the subject matter of advice can still facilitate the scaling of advice:

> [1.34] This process is designed to accommodate the provision of limited advice (also referred to as 'scaled advice') that only looks at a specific issue (for example, single issue advice on retirement planning) and 'holistic' advice that looks at all the financial circumstances of the client...As long as the provider acts reasonably in this process and bases the decision to narrow the subject matter of the advice on the interests of the client, the provider will not be in breach of their obligation to act in the client's best interests. The scaling of advice by the provider must itself be in the client's best

42 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.

43 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 11–12.

> interests, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances.[44]

4.43 Submitters pointed to differences in expressions used in the Bill and EM; subparagraph 961B(2)(b)(ii) refers to the client's *relevant* circumstances, while the EM claims that advisers must take into account the client's *overall* circumstances when determining the subject matter of advice. AMP Financial Services stated with regards to their ability to provide scaled advice:

> In our interpretation of the bill at present it would be very difficult for us to do so because of the point I alluded to earlier that, in the way that the bill is currently drafted, we would be required to consider the client's whole financial position, even if the client came in saying they only wanted to consider one component of their finances.[45]

4.44 Several submitters argued that the wording in subsection 961B(2) should be amended to explicitly allow the provision of scaled advice.[46] The FSC argued that the ability to scale advice should be clearly expressed in the legislation to provide additional clarity:

> 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.[47]

4.45 The ISN offered an alternative view, arguing that there is no issue with the provision of scaled advice under the best interests obligations imposed by the Bill:

> There is nothing in the best interests duty as drafted within s961B which is inconsistent with the delivery of scaled or limited scope financial advice. Industry super funds, who have been market leaders in terms of rolling out limited scope financial advice services to members on their superannuation, are supportive of this duty.[48]

4.46 AustralianSuper agreed with this position, stating that the best interests duty is compatible with the provision of scaled advice and intra-fund advice in its current

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44 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 12.

45 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 4.

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

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

48 Industry Super Network, *Supplementary Submission 121*, p. 2.

form, and strikes the appropriate balance between protecting consumers and providing clarity to advisers by providing steps to demonstrate compliance.[49]

4.47 Treasury officials explained that the intent of the wording in the legislation and EM was to help facilitate scaled advice while protecting consumers, and emphasised that only relevant investigations would need to be made by advisers when scaling advice. Treasury commented that the policy intention is to allow clients and advisers to agree to the scope of advice:

> ...This is scaled advice. They should be able to work out scaled advice, but I will give you an example which I put to AMP. If a person walked through the door and said that they wanted some financial advice on how to do some margin lending or get some contracts for difference, there must be an obligation on a financial adviser not to just say, 'Okay—hand us over the money, and we'll organise it for you.' The idea of the way that the legislation and the explanatory memorandum are set out is that the financial service provider would make enough inquiries to decide whether that was suitable or not.[50]

4.48 In commentary on the use of the term 'overall' in the EM, Treasury stated:

> ...I would read 'overall' down to say that if a person—say it was someone around this table—walked into a financial adviser and wanted to do margin lending, some enquiries would have to be made—.[51]

4.49 However, in response to committee questioning, Treasury commented that it would be helpful to clarify in the EM that it is 'relevant' rather than 'overall'.[52]

4.50 Additionally, ASIC made it clear that it intends to provide regulatory guidance to assist advisers in providing scaled advice in a manner which is consistent with their best interests obligations. ASIC noted that it has already provided guidance on scaling advice through several regulatory guides[53] and a July 2011 Consultation Paper *Additional guidance on how to scale advice* (CP 164). ASIC will finalise its guidance on scaling advice in 2012, taking into account the best interests duty proposed in the Bill:

> Once the new obligations are in place, ASIC will continue to provide guidance with the aim of increasing access to advice by facilitating industry

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49 AustralianSuper, *Submission 38*, p. 2.

50 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

51 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

52 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

53 Namely Regulatory Guide 200, *Access to advice for super fund members*; Regulatory Guide 84, *Super switching advice: Questions and answers*; and Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*.

> to provide scaled advice while complying with the relevant advice obligations (as we have in the past with RG 200 and CP 164). This guidance will discuss a range of topics, including how the fact find process in giving advice can be either limited or expanded, depending on the complexity of the advice being provided.[54]

Use of computer programs to deliver scaled advice

4.51 The EM to the Bill notes that the 'best interests' provisions are designed to take into account the fact that computer programs are increasingly being used to provide advice to clients.[55] The Bill attempts to facilitate this when defining the 'provider' of advice by including subsection 961(6), which provides:

> A person who offers personal advice through a computer program is taken to be the person who is to provide the advice, and is the ***provider*** for the purposes of this Division.

4.52 Several submitters questioned the intent of this provision, noting that the provision of scaled advice by electronic facilities may make advice accessible to individuals who otherwise may not access it.[56] Despite the intent in subsection 961(6) to allow advisers to use computer programs to give advice, the FSC commented that there is no clear guidance on how a provider might give advice through a computer system and satisfy the best interests obligations in section 961B. Some of the potential issues raised by the FSC include that computer programs:

- cannot comply with a broad undefined duty to act in the best interests of clients;
- must be able to determine the scope of advice offered, which is not possible under the best interests obligations as drafted, which only allow the client to scale the advice sought;
- are unlikely to be able to determine whether any information entered by a client is inaccurate;
- will not always be able to determine whether it is reasonable to consider recommending a financial product, or how broad a range of products the computer program needs to consider to satisfy the best interests obligation; and
- cannot take any other step that would reasonably be regarded as being in the best interests of the client, as required by paragraph 961B(2)(g).[57]

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54 ASIC, *Supplementary submission 28*, pp 11, 12.

55 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 9.

56 Financial Services Council, *Submission 58*, p. 49; Australian Institute of Superannuation Trustees, *Supplementary submission 18*, p. 2; Australian Bankers' Association, *Submission 67*, p. 18.

57 Financial Services Council Ltd, *Submission 58*, pp 49–50.

4.53 Further clarification may be required either in legislation or regulations to explain how the provision of scaled advice through computer programs or other electronic facilities can be undertaken in the context of the best interests obligations in section 961B.

Scope of the best interests duty and proposed carve-outs

4.54 The Bill proposes limited carve-outs from the best interests obligations for the provision of basic banking products and general insurance products.

4.55 Subsection 961B(3) provides that employees of an Australian Authorised Deposit-taking Institution (ADI) offering advice relating to basic banking products need to satisfy only the steps in paragraphs 961B(2)(a)-(c) in order to satisfy their best interests obligation. Similarly, subsection 961B(4) states that if the subject matter of advice sought by a client is solely a general insurance product, a provider needs to only take the steps in paragraphs 961B(2)(a)-(c) to fulfil their obligation.

4.56 Under subsections 961J(2) and 961J(3), advice provided on basic banking products and general insurance products is also exempted from the requirement in subsection 961J(1) that a provider must give priority to the client's interests in the event of any conflict of interest.

4.57 The EM explains the rationale behind the provision of this limited carve-out from the best interests obligations:

> Basic banking products and general insurance are recognised as being simple in nature and are more widely understood by consumers. This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, a modified best interests obligation more appropriately balances the benefits to consumers with the compliance costs to providers.[58]

4.58 Treasury explained to the committee why the limited carve-out approach had been adopted in relation to basic banking advice. It noted that some of the provisions relating to the appropriateness of advice in section 945A, which currently must be adhered to by banks, had effectively been transferred across to the new provisions in paragraphs 961B(2)(a)-(c):

> What we have done with the legislation, banks are currently subject to section 945A in the Corporations Act and that has a number of steps that have to be taken and a requirement that the advice be appropriate. That currently applies to the banking sector. With the revised best interest duty, we have taken some of the process steps out of 945A and included them in the new best interest duty and we also have the appropriate advice provision in the new bill. What we have done is say that those steps that the banks used to be subject to under 945A they will continue to be subject to in the

58 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 16.

> new legislation and they will also be subject to the appropriate advice test in the new legislation.[59]

4.59 Treasury concluded that 'the intention is to reflect as far as possible the banks' current position' that is, business as usual in relation to basic banking.[60]

4.60 The Insurance Council of Australia welcomed the limited carve-outs applied to basic banking and general insurance products, and agreed with Treasury that the applicable provisions in paragraphs 961B(2)(a)-(c) largely reflect the current requirements under section 945 of the Act.[61]

Advice relating to basic banking products

4.61 Stakeholders from the banking industry disagreed with Treasury's assessment of the situation for basic banking products. The Australian Bankers' Association (ABA) expressed concern that the elements contained in paragraphs 961B(2)(a)-(c), which will still apply to basic banking products, could significantly extend the obligations for bank staff and bank specialists, and even lead to banks declining to provide personal advice:

> As currently drafted, the carve out from the best interests duty is unclear and not absolute, and therefore will create additional regulation, which will likely make it too difficult and too costly for some banks to continue to provide advice on basic banking products.[62]

4.62 The ABA noted that banks currently pursue a variety of models for providing financial advice, based on the differences between how factual information, general advice and personal financial advice are regulated.[63] As the new best interests obligations only apply to the provision of personal advice, the ABA argued that some banks may adopt a 'no advice' model in order to avoid the legal and compliance uncertainties associated with offering personal advice under the FOFA reforms,[64] with the effect of decreasing access to advice for consumers.

4.63 Abacus, the peak body for Mutuals in Australia, advocated for a 'clear and unambiguous carve-out from the best interests duty for advisers on basic banking products'.[65] Both Abacus and the ABA suggested that section 945A be retained in the

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59 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p .65.

60 Ms Sue Vroombout, Treasury, General Manager, Retail Investor Division, *Committee Hansard*, 24 January 2012, p. 65.

61 Insurance Council of Australia, *Supplementary Submission 39*, p. 3.

62 Australian Bankers' Association, *Supplementary Submission 67*, p. 4.

63 Ms Diane Tate, Policy Director, Australian Bankers' Association *Committee Hansard*, 23 January 2012, p. 22.

64 Australian Bankers Association, *Supplementary Submission 67*, p. 4.

65 Abacus Australian Mutuals, S*upplementary Submission 141*, p.5.

legislation for basic banking products, allowing for a fuller exemption from the new best interests requirements for these products.[66]

Opposition to the proposed carve-outs

4.64 Some stakeholders opposed the inclusion of carve-outs for basic banking and general insurance products altogether. The Joint Consumer Groups rejected the notion that basic banking products and general insurance are simple and well-understood by consumers, claiming that 'basic banking products and general insurance products are still capable of being mis-sold, especially by advisers with incentives to mis-sell, and poor quality advice in relation to these products can still lead to consumer detriment'.[67] They also claimed that the requirement for advisers to consider and investigate the subject matter of the advice, which is part of the current legal obligations under section 945, is not incorporated into paragraphs 961B(2)(a)-(c). The consumer groups asserted that this will result in 'a lowering of the standard of advice in relation to financial products that can be considered essential and, in fact, almost mandatory for the average consumer'.[68]

4.65 The Trust Company argued that the exemptions for basic banking products and general insurance products, on the basis that these products are more simplistic in nature, are inconsistent with the goal of raising the standard and professionalism of financial advice across the industry.[69]

Committee view

4.66 The committee considers that the introduction of a statutory best interests duty for financial advisers to act in the best interests of their clients is a vital reform for the financial advice industry. This duty will help increase the professionalism of the industry and provide additional protection for consumers.

4.67 The committee believes that the formulation of the best interests obligation in the Bill strikes an adequate balance between providing certainty for the industry while ensuring professional standards are raised. The committee notes the concern expressed by some stakeholders regarding the inclusion of paragraph 961B(2)(g), but believes this paragraph is necessary to achieve the objective of increasing professionalism in the industry.

4.68 The committee commends the Bill for promoting the provision of scaled advice. For added clarity, the committee believes that paragraph 1.33 of the EM should be redrafted to refer to the client's *relevant* circumstances rather than the

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66 Abacus Australian Mutuals, S*upplementary Submission 141*, p.5; Australian Bankers' Association, *Submission 67*, p. 12.

67 Joint Consumer Submission, *Supplementary Submission 25*, pp 5–6.

68 Joint Consumer Submission, *Supplementary Submission 25*, pp 4–5.

69 The Trust Company, *Submission 53*, pp 7, 9.

client's *overall* circumstances. The committee considers that this change, along with additional regulatory guidance from ASIC, will allay industry concerns about the ability for advisers to offer scaled advice.

4.69 The committee considers that the limited carve-outs from the best interests obligations for basic banking and general insurance products are warranted and will facilitate the provision of advice relating to these products to consumers.

Recommendation 4

4.70 The committee recommends a revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be issued such that the final sentence in paragraph 1.33 of the Explanatory Memorandum reads:

> **'In identifying the advice that has in effect been sought by the client (including advice implicitly sought by the client), the provider must take into account the client's relevant circumstances.'**

Chapter 5

Bans on conflicted remuneration

5.1 The committee's inquiry into financial products and services in Australia noted that the financial advice industry originated as a cohort of sales staff representing financial product manufacturers. Advisers were remunerated based on the value of products sold and their fee was deducted from the amount paid by the consumer for the product. The origins of the industry, however, do not align with contemporary consumer expectations that financial advisers provide a professional service acting in the best interest of their clients. In the current market, advisers typically play a dual role of providing advice as well as acting as sales representatives for financial product manufacturers.[1]

5.2 Up-front commissions, charged as a percentage on the initial investment, and trail commissions, charged at ongoing intervals as a percentage of assets, are a common form of benefit provided to advisers. In some cases, advisers will encourage consumers to gear their investment portfolios (use borrowed funds) to enable the adviser to increase the benefit of asset-based fees.[2] This creates a clear conflict of interest between adviser and consumer and has a negative impact on the quality of advice provided. In the collapse of Storm Financial, for example, it was found that in some cases there was insufficient consumer understanding of the risk of borrowing against the equity of a family home.[3]

5.3 The Australian Securities and Investments Commission (ASIC) outlined some of the features of commissions:

> The distinguishing feature of commissions is that they are an arrangement between the product issuer and the adviser or the adviser's licensee and they are built into the product. That is, the commissions are incorporated into the fees paid by the client to acquire or hold the product. After the investor has invested in the product, the investor cannot control the commission.
>
> Commissions as a 'built in' feature of products also distort the cost of advice. Retail clients are unaware of the true cost of receiving personal financial advice as this is often bundled into the overall fees they pay for financial products.

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1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 69–70.

2 The Treasury, *Submission 22*, p. 9; Joint Consumer Groups, *Supplementary Submission 25*, pp 9–10.

3 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 28.

> Because the commission is built into the product, it is often difficult to draw a link between the commission and the advice service provided. For example, industry argues that trail commissions are in effect payment for ongoing advice services provided to the client or ongoing administrative costs, for example, the costs of monitoring the client's portfolio. However, trail commissions are often paid regardless of whether there is any ongoing advice or service.[4]

5.4 Conflicts of interests can also arise where advisers are authorised representatives of a licensed advisory group owned by a product manufacturer, creating a vertically integrated model.[5] Consumers are not necessarily aware of this relationship and of the inherent conflicts of interest that will arise.

5.5 An additional element in the chain of commission-based payments is the platform operator which can act as a conduit for various product providers to licensees. A product manufacturer will pay a volume-based shelf-space fee, to the platform operator to receive preferential treatment for their product when the operator is interacting with licensees.[6] The fee amount paid by a product manufacturer is wholly, or partly, determined by the total number or value of products listed with the platform operator.[7] The consumer, when offered and subsequently purchases a financial product, is unlikely to be privy to the incentives offered to either the platform operator or the adviser.[8]

5.6 The bans on conflicted remuneration target the effect of these sales-incentives on the quality of advice.

5.7 The second tranche of the FOFA Bills, the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill) amends the *Corporations Act 2001* (the Act) to ban the payment and receipt of certain remuneration which could influence the advice licensees provide to consumers in relation to financial product advice.[9] Payments banned include:

- commissions;
- volume payments from platform operators to financial advice dealer groups;
- volume-based shelf-space fees paid by funds managers to platform operators;

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4 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 13.

5 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 75, 79.

6 Jennifer McDermott, 'What's that: Shelf-space fees', *The Australian*, 9 June 2010.

7 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Subsection 964A(2).

8 Joint Consumer Groups, *Supplementary Submission 25*, pp 8-9.

9 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

- asset-based fees on borrowed amounts; and
- soft dollar benefits over an amount prescribed by regulation (proposed to be $300), as long as the benefits are not identical or similar and provided on a frequent or regular basis.[10]

5.8 The Explanatory Memorandum (EM) outlines that Australian Financial Services Licensees (AFSLs) are remunerated differently from many other occupations and that traditionally advisers have received commissions from product providers for placing clients with particular products:

> Product commissions may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.
>
> There is some evidence that these conflicts affect the quality of advice. The 2006 Shadow Shopping exercise of the Australian Securities and Investments Commission (ASIC) found that advice that was clearly or probably non compliant was around six times more common where the adviser had an actual conflict of interest over remuneration. The conflict of interest may lead to advice that is not compliant and not in the client's interests.[11]

Exceptions from conflicted remuneration

5.9 As noted in chapter 2, there are some exceptions to the bans on conflicted remuneration including:

- general insurance;
- life insurance which is not bundled with a superannuation product;
- group life policies for members of a superannuation fund;
- individual life policies which are not connected with a default superannuation fund;
- execution-only (non-advice) services;
- non-monetary benefits in relation to general insurance;
- soft-dollar benefits under the amount prescribed by regulation (proposed to be $300);
- soft-dollar benefits with an education or training purpose (to be clarified in regulation);

10 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 7, 30–31.

11 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

- soft-dollar benefits that provide information technology software or support;[12] and
- employees or agents of an Authorised Deposit-taking Institution (ADI) that are providing advice on basic banking products.[13]

5.10 Volume-based payments will also be excepted where it can be proven that the benefit of the payment is not conflicted (see paragraph 5.24).

5.11 It is also proposed that regulations will address stockbroking activities where a person receives third party 'commission' payments from companies when the payments relate to capital raising be excluded from the bans on conflicted remuneration (discussed further in chapter 7, paragraph 7.42).[14]

5.12 The following matters are discussed in this chapter:

- Volume-based rebates;
  - the impact on bank tellers;
  - the impact on corporate superannuation;
- risk insurance inside superannuation;
- asset-based fees on borrowed amounts; and
- grandfathering.

Submitters' views

5.13 There was broad support among industry participants for the ban on conflicted remuneration and the government's policy goals of improving the integrity and professionalism of the industry and increasing consumer confidence in financial planners. There is, however, some disagreement on the proposed conflicted remuneration provisions and the related carve-outs. These views are discussed below.

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12 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 24.

13 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 33.

14 Subject to further consultation, it is proposed that the receipt of 'stamping fees' from companies for raising capital on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market.
Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

General advice

5.14 The Australian Bankers' Association (ABA) noted that while the best interests duty relates only to personal advice, the conflicted remuneration provisions apply to benefits on personal advice, general advice and the distribution of financial products.[15]

5.15 The Superannuation Committee of the Law Council of Australia voiced concerned that the definition of conflicted remuneration is 'defined in very general terms' and is not limited to remuneration for 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).[16]

5.16 The Law Council has requested that product and service fees accumulated as a result of general advice be specifically excluded from the definition of conflicted remuneration in the forthcoming regulations.[17]

5.17 The Financial Services Council (FSC) and the ABA noted that by definition, general advice must be accompanied by a warning that the advice does not consider the clients' individual personal circumstances, and the client should consider their personal circumstances and the accompanying disclosure documents before making a decision.[18] FSC submitted that general advice is:

- 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;
- far less influential on the decision of a retail client than personal advice; and
- not the context in which the issues and concerns referred to in the Explanatory Memorandum arise.[19]

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15 Australian Bankers' Association, *Submission 67*, p. 10.

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

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

18 Australian Bankers' Association, *Submission 67*, p. 10; Financial Services Council, *Submission 58*, p. 76.

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

5.18 The ABA recommended that the bans on conflicted remuneration should not apply to general advice; rather, it should encourage the use of scaled advice. ABA asserted that general advice is an important element in filling the financial advice gap for many Australians.[20]

5.19 Further, the FSC highlighted that general advice is included in broadcasts and media advertising, newsletters, websites, seminars, product brochures (such as a product disclosure statement), call-centre operations and billboards. In addition, it may not be product specific and has a broader educational or informative purpose.[21]

5.20 The FSC submitted that exemptions for general advice are required given the low threshold for determining whether the benefit might influence advice.[22] ABA also suggested that regulations should prescribe an exemption for general advice in relation to basic financial products, including simple super products, simple wealth products, and retirement savings accounts.[23]

Committee view

5.21 The committee considers that the bans on conflicted remuneration should apply to general advice and that advisers can utilise a fee-for-service model when offering this form of advice.

Volume-based rebates

5.22 Currently, employers can pay incentives to advisers to sell a certain type or a certain volume of products. The Bill proposes to prohibit volume-based shelf-space fees paid by funds managers to platform operators and volume payments from platform operators to financial advice dealer groups.[24]

5.23 One of the key concerns with the ban on volume-based remuneration was the impact it would have on competition in the market, and the risk that dealer groups would restructure their enterprises into vertically integrated models to retain the income that they otherwise would have received from volume rebates. These concerns, and the anti-avoidance provisions designed to address them, are discussed further in chapter 6.

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20 Australian Bankers' Association, *Submission 67*, p. 11.

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

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

23 Australian Bankers' Association, *Submission 67*, p. 39.

24 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 25–26, 35–36.

Volume-based fees as a fee for service or scale efficiencies

5.24 A benefit is presumed not to be a volume-based shelf-space fee if it is proved that all or part of the remuneration is a fee for service or a discount that does not exceed the reasonable value of scale efficiencies:

> The Bill assumes that the platform operator will be aware of the nature of any discount or rebate it receives, and will therefore be aware of whether a payment is a genuine fee for service, or represents genuine scale efficiencies. It is therefore appropriate that the platform operator bear the onus of proving that the payment ought to be presumed not to be a volume-based shelf-space fee.[25]

Calls for greater restrictions on platform fees

5.25 The Joint Accounting Bodies (JAB) believed there is a risk in allowing volume-based shelf-space fees in instances where it is proven that all or part of the remuneration is a fee for service or a discount that does not exceed the reasonable value of scale efficiencies. JAB suggested that, alternatively, platform operators should only be able to receive an asset management fee discount in the form of a rebate where it represents a reasonable value of scale efficiencies. JAB argued that the value of the rebate should be passed on to clients invested in the respective fund manager.[26]

5.26 The Joint Consumer Groups (JCG) argued that non-volume-based benefits paid to secure preferential treatment on a platform should not be allowed:

> Flat fee payments, especially if very large and bearing no relation to the costs of the platform operator, could easily distort product recommendations given to retail clients. For example, the payment of such a fee by a particular product issuer may lead to increased recommendations to acquire the products of that issuer, in much the same way that, in the past, high commissions have lead to recommendations to acquire certain products.[27]

5.27 JCG recommended that the ban should include 'any other benefit provided by a product to a platform operator, other than:

- fees for services provided by the platform operator which reasonably represent the market value of those services;
- the purchase price for property which reasonably represents the market value of the property; and

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25 Treasury, *Submission 22*, p. 9, see also Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 36.

26 Joint Accounting Bodies, *Supplementary Submission 23*, p. 5.

27 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

- genuine education or training benefits'.[28]

5.28 Should the above amendment not be made, JCG recommended that the Bill require ongoing, public disclosure of all payments by product providers to platform operators on a publicly accessible website.[29]

5.29 In his Second Reading Speech, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, outlined that it would be in the interest of advisers to act prudently when determining whether remuneration could be considered to influence their advice:

> If an adviser is confident that a particular stream of income does not conflict advice, then these reforms do not prevent them from receiving that income. For example, in the case of the receipt of income related to volume of product sales or investible funds, there is a presumption that that income would conflict advice. However, this is a presumption only, and if the adviser can demonstrate that the receipt of the income does not conflict advice then such remuneration will be permissible under the bill.
>
> But the message is clear—if in doubt about whether certain remuneration will conflict the advice that they provide to their client—the adviser would be prudent to err on the side of caution.[30]

Proving fee for service and value of scale efficiencies

5.30 The Superannuation Committee of the Law Council of Australia was concerned with the provision that certain benefits are conflicted remuneration unless proven otherwise:

> While the Committee agrees that not all volume based benefits are conflicted remuneration, it has a real concern about how the section will operate in practice. On what basis can it be proved that a volume based benefit is not conflicted remuneration and to whom? Read literally, a volume based benefit will be conflicted remuneration until such time as it is proved not to be. In the Committee’s opinion, the provision does not give any certainty to the industry or to employers.[31]

5.31 The FSC believed the current drafting of subsection 964A(2), which defines a volume-based shelf-space fee, does not permit genuine dollar-based shelf-space fees charged by platform operators.[32] Further, Westpac is concerned that it will be an

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28 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

29 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

30 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 24 November 2011, p. 13752.

31 Law Council of Australia, *Submission 5*, p. 10.

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

impossible task for a platform to ascertain and prove the value of scale efficiencies of a fund manager:

> ...the way that section 964A(3)(b) is drafted, the onus is on the platform to prove the efficiencies gained by the fund manager which is difficult, if not impossible. Discounts and rebates will differ across the funds management industry as each will have different economies of scale across different asset classes. In addition, the fund manager's economies of scale can differ depending on the platform (e.g. services the platform takes on, technology interfaces between the platform and fund manager). The discount is also subject to confidential and commercial negotiations between the fund manager and platform and may differ depending on the bargaining power of either party.[33]

5.32 The Law Council recommended that a materiality threshold should be included in the Bill, and a ruling system for ASIC to determine which benefits are deemed conflicted remuneration and which are not.[34] Westpac also suggested that legislative guidance on how to prove that efficiencies have been gained by the funds manager should be provided. It suggested a reasonable option could be a bona fide arms length negotiated agreement between the funds manager and the platform operator.[35]

5.33 FSC recommended that subsection 964A(2) be amended to ensure annual or one-off dollar based fees (not related to volume) that are operational in nature be carved out from the definition of a volume-based shelf-space fees.[36]

5.34 The EM outlines that, when determining a reasonable value of scale efficiencies, regard should be given 'to what might be reasonable in all the circumstances, including, for example, the relative bargaining power between the particular funds manager and the platform operator'.[37]

Committee view

5.35 The committee acknowledges the calls from industry for greater certainty in determining which volume-based fees will be permitted under the Bill. It recommends that Treasury establish a materiality threshold in the regulations to outline what percentage of a volume-based fee constitutes a genuine value of scale efficiencies and what constitutes 'a reasonable fee for service'. Further, the regulations should require product providers to publicly disclose permissible volume-based payments made to

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33 Westpac Group, *Submission 64*, p. 26.

34 Law Council of Australia, *Submission 5*, p. 10.

35 Westpac Group, *Submission 64*, p. 26.

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

37 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 36.

platform operators on their websites, and financial advisers should disclose volume-based benefits received in product disclosure statements.

5.36 In addition, the committee recommends that ASIC issue guidance material on how licensees can prove that efficiencies have been gained when in receipt of a volume-based benefit. This may include written agreements between product providers and platform operators which outline genuine value of scale efficiencies, or a reasonable fee for service framed around requirements specified in the regulations.

Recommendation 5

5.37 The committee recommends that regulations pertaining to paragraph 964A(3) of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be drafted to include a materiality threshold to determine when a benefit is not presumed to be a volume-based shelf-space fee. The regulations should specify that full disclosure is required for the payment and receipt of these benefits.

Recommendation 6

5.38 The committee recommends that the Australian Securities and Investments Commission (ASIC) issue guidance material for platform operators who seek to substantiate a claim that a volume-based payment demonstrates a reasonable fee for service or a genuine value of scale efficiencies.

Impact on bonuses for bank tellers

5.39 ABA submitted that the ban on volume-based fees could be interpreted to prohibit the payment of performance bonuses for bank staff, as performance bonuses relate to volume, or in some cases, an aggregate net improvement in their client's net position:

> The ABA submits that performance pay for bank employees is beyond the policy intent of the FOFA reforms. Furthermore, it does not automatically follow that a client is at risk of receiving advice which is conflicted merely because an adviser may receive part of their remuneration in the form of a performance bonus payment from their employer based on their overall activities for the year and the overall service provided to retail clients.[38]

5.40 ABA submitted that the structure of performance-based remuneration can be designed to foster productivity, innovation and efficiency, industry competeiveness and global competeiveness.[39] In addition, banks use a balanced scorecard approach which uses both financial and non-financial measures to determine incentive eligibility:

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38 Australian Bankers' Association, *Submission 67*, p. 25.

39 Australian Bankers' Association, *Submission 67*, pp 25–26.

> Incentive plans or variable rewards schemes can be based on a balanced scorecard approach where performance outcomes and behaviours are measured, such as customer satisfaction and quality (based on proxies used to ensure product sales meet customer needs and the product is used), community engagement, culture and employee management, self-development, financial and risk management, strategic process and quality, and revenue (based on individual or overall team performance). Measures are both financial and nonfinancial. The actual percentage of a scorecard relatable to a revenue measure varies from bank to bank, function to function, and individual to individual.[40]

5.41 ABA believed that bonus arrangements for bank staff should not be considered conflicted remuneration where incentive plans are not specifically volume-based, or 'wholly and directly linked to specific sales targets of a class of products, or where individual sales volume does not solely determine the incentive payment'.[41]

5.42 ABA recommended that the Bill should be amended to exempt volume-based payments that are not 'wholly or directly' (rather than 'wholly or partly') related to the value or number of financial products and argued that:

> In the absence of amendment and clarification, this could result in all bank staff not being rewarded and the removal of certain discretionary incentive structures, including performance bonus payments based on balanced scorecard methodology.[42]

5.43 ANZ noted that the EM 'appears to recognise the balanced scorecard approach as an acceptable remuneration arrangement':[43]

> If an employees is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to the volume is presumed to be conflicted. However, if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of the financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned.[44]

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40 Australian Bankers' Association, *Submission 67*, p. 26.

41 Australian Bankers' Association, *Submission 67*, p. 27.

42 Australian Bankers Association', *Submission 67*, p. 28. S963L of the Bill states that a benefit is conflicted unless it 'is *wholly or partly* dependent on the total value of financial products of a particular class'.

43 ANZ Wealth, *Supplementary Submission 29*, p. 5.

44 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 28.

Committee view

5.44 The committee believes that the carve-out from the conflicted remuneration bans for Authorised Deposit-taking Institutions (ADIs) providing advice on basic banking products is sufficient to allow for current performance-based remuneration structures in ADIs to continue.

Impact on corporate superannuation

5.45 Another group claiming they will be adversely, and unintentionally, affected by the ban on volume-based fees are the corporate superannuation specialists. This group engage in contracts with employers, providing newsletters and offer seminars in the workplace to educate employees.[45] Less than 10 per cent of corporate super specialist firms receive remuneration directly from their employer, the remainder receive income from the fund managers.[46] The Corporate Superannuation Specialist Alliance (CSSA) outlined that employers prefer the current form of remuneration for corporate super specialists and do not want an additional expense on top of their super contributions.[47]

5.46 The Boutique Financial Planning Principals Group (BFPPG) detailed its experience with several thousand members of corporate super funds totalling more than $100 million and an average member balance of $30,000. The BFPPG commented that 'the most efficient, cost effective way of being remunerated is through platform fees'. The BFPPG argued that without the services of corporate super specialists, the responsibility will fall back on the trustee who will have to increase administration fees to provide cover for their members, and as a result there will be no cost saving for consumers.[48]

5.47 The BFPPG also raised concerns that the measure will remove corporate superannuation specialists' services from the market and argued that this 'goes directly against government's stated aim of promoting choice and enabling access to quality advice at a low cost':

> Removing that ability to be remunerated will result in an inability to service clients, members will be predominantly invested in the fund’s default option, with little or no understanding of their super, little or no opportunity to salary sacrifice, unaware of co-contributions or transition to retirement

45 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 79.

46 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 81–82.

47 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77. For further assertions on the lack of transparency in intra-fund advice see Financial Services Council, *Submission 58*, pp 70, 73–74.

48 Boutique Financial Planning Principals Group, *Submission 48*, p. 8.

> strategies and with no inclination or interest in investing more into their super since there will be no one to advise them.[49]

5.48 The CSSA is made up of over 50 firms.[50] It was formed in response to the proposed reforms in the sector and concern that corporate superannuation specialists would unintentionally be caught by restrictions intended for financial planners. CSSA was also concerned that the proposed reforms will jeopardise the viability of the services they offer:

> One reason the fees are so low in this sector of the superannuation industry is that we have negotiated on behalf of our clients to reduce the fee they pay. We also negotiate lower insurance premiums and higher levels of the automatic insurance cover which people get. This assists many people to get insurance cover which they may not otherwise be eligible for. We provide proactive financial education, advocacy and services delivered to the workplace. We believe the services we are providing fit perfectly with the government's goal to assist more people to seek financial advice, to be financially independent and to reduce dependence on social security, therefore creating less of a burden for future generations of taxpayers. Why then does the proposed legislation not provide a method for us to be paid for our valuable services? Why must we be forced into extinction?[51]

5.49 CSSA went on to state that if payments are channelled into an administration fee paid by a fund, rather than an ongoing commission, the fee for service will be hidden in the costs of the intra-fund advice[52] of fund managers:

> The only possible option is to revert to what ultimately looks like another form of commission and that is for us to be paid by the super fund trustees as part of the totally untransparent intrafund advice fee. We believe that any fee paid to us should be explicit and transparent and should be agreed between the party providing the service, being us, and the party receiving the service, being our clients.[53]

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49 Boutique Financial Planning Principals Group, *Submission 48*, p. 8.

50 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 81.

51 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77.

52 Intra-fund advice is personal financial advice without a full 'know your client' process. The advice must relate only to a member's account within the superannuation fund. Intra-fund advice can be provided over the phone, via email or face-to-face. Under the intra-fund advice rules, a super fund cannot provide advice on switching super funds, advice on financial products outside super, or advice on general retirement planning. SuperGuide: Simple independent superannuation information, 'Intra-fund advice', http://www.superguide.com.au/superannuation-topics/intra-fund-advice (accessed 3 February 2012).

53 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77. For further assertions on the lack of transparency in intra-fund advice see Financial Services Council, *Submission 58*, pp 70, 73–74.

5.50 CSSA argued that its member firms provide a service that cannot be compared to the education, or general advice, services provided by fund managers that are in a vertically integrated model. It argued that if consumers are forced to deal directly with product providers, they will find it much more difficult to receive unbiased advice, particularly in the case when they opt to pay an additional fee for personal advice. In this case it would be 'unlikely that, for example, an AMP employee will recommend a product from MLC'.[54]

Committee view

5.51 The committee considers that corporate superannuation specialist firms promote choice in the market and these valuable services should continue to be provided. The committee emphasises that employers may choose the form of remuneration most suitable to their circumstances following the reforms.

5.52 The committee believes that corporate superannuation specialist firms should continue to receive benefits where they represent a 'reasonable fee for service' or a value of scale efficiencies.[55]

5.53 The committee proposes that Treasury conduct further consultation with the corporate superannuation specialists firms to discuss alternative viable models of remuneration that align with the FOFA reforms.

Risk insurance inside superannuation

5.54 Remuneration for general insurance and life insurance products outside superannuation are allowed under the provisions of the Bill. However, the following forms of remuneration are considered conflicted:

- group-life insurance bundled with superannuation; and
- life insurance bundled with default superannuation.

5.55 The National Insurance Brokers Association of Australia (NIBA) stated that the focus of the reforms has been financial planning and wealth management, not risk insurance. As a result the 'risk insurance industry has not had the opportunity of a review similar to that undertaken in relation to...the financial advisory industry'.[56]

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54 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 78 (see also see also pp 80–81 for a discussion on the difference between personal and general advice).

55 See paragraph 964A(3)(b) of the bill, which describes a value of scale efficiencies as 'a discount on an amount payable, or a rebate of an amount paid, to the funds manager by the platform operator, the value of which 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 in relation to which the funds manager provides services to the platform operator, or through the platform operator to another person'.

56 National Insurance Brokers Association of Australia, *Submission 59*, p. 4.

NIBA highlighted that no evidence has been provided to warrant significant reforms to the risk insurance industry:

> A recent industry review by ASIC found no such problems and the regime (effectively Chapter 7 of the Corporations Act and general law) is working well for insurance brokers and their retail clients. In particular, this is evidenced by the low level of disputes referred to the Financial Ombudsman Service (FOS) in relation to insurance brokers. Insurance brokers are effectively being tarred by the same brush as financial advisers for no good reason.[57]

5.56 NIBA also emphasised that insurance products can be complex and difficult to understand, and that the services of a professional adviser can assist consumers to get the coverage they need at an appropriate price, and in turn reduce claims issues.[58]

Increased levels of underinsurance?

5.57 Some submitters argued that bans on life insurance inside superannuation will increase levels of underinsurance in Australia.[59] IOOF Holdings commented:

> 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.[60]

5.58 The Association of Financial Advisers (AFA) put the view that risk insurance inside superannuation should remain outside the FOFA remuneration changes on the grounds that is has a similar set up to general insurance type products (which are exempt from the bans), it has an annual renewal period and a defined benefit/risk.[61] Accordingly, the AFA recommended:

> ...that this area be the subject of greater research and investigation. In the context of corporate superannuation and group life insurance, there needs to

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57 National Insurance Brokers Association of Australia, *Submission 59*, p. 5.

58 National Insurance Brokers Association of Australia, *Submission 59*, p. 6.

59 FYG Planners Pty Ltd, *Submission 50*, p. 2; National Insurance Brokers Association, *Submission 59*, p. 6.

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

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

> 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.[62]

Committee view

5.59 The committee believes a fee for service model is appropriate when advice is provided for risk insurance products bundled with superannuation products. For example, in the case where a client is required to pay a fee for service after lodging a claim for the death or injury of a partner, the Bill allows for the fee for service to 'be given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client'.[63] Namely, the client can direct that the fee for service be taken from the client's investment, or product issuer in the case where they do not choose to pay the fee directly.

Remuneration on all risk insurance products should be banned

5.60 The Industry Super Network (ISN) argued, however, that commission on all personal risk products should be included in the ban, including those outside superannuation.[64] JAB agreed and argued that the carve-out for insurance outside superannuation 'encourages the retention of conflicted remuneration models':[65]

> We believe the inconsistency in how commissions on insurance for life risk products sold outside of superannuation and individual life risk policies within superannuation for non-default funds adds unnecessary complexity. Further, it encourages the retention of conflicted remuneration models. All payments deemed to be conflicted remuneration should be regulated consistently.
>
> Choosing to not ban conflicted remuneration on life risk insurance products in these specific circumstances, irrespective of the best interests obligation, risks the continued provision, perceived or real, of inappropriate advice to consumers who seek advice on these products.
>
> The Joint Accounting Bodies do not believe there are sufficient grounds to warrant these products being excluded from the regulation proposed to apply to other like products. Such ‘carve-outs’ add complexity and cost to the provision and administration of advice, which will ultimately be passed on to the consumer.[66]

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

63 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Paragraph 2.26, pp 29–30.

64 Industry Super Network, *Submission 12*, p. 2; Industry Super Network, *Supplementary Submission 12*, p. 4.

65 Joint Accounting Bodies, *Supplementary Submission 23*, p. 3.

66 Joint Accounting Bodies, *Supplementary Submission 23*, pp 3–4.

5.61 JCG believed allowing a carve-out for life risk insurance commissions outside superannuation may exacerbate the 'mis-selling and churning' of life risk insurance 'especially as, after the commencement of the Bill, life risk insurance will be the product that is most likely to provide financial advisers with commission income'.[67]

5.62 Treasury told the committee that 'the risk of possible reductions in insurance advice is one of the main reasons why the government decided not to ban all insurance commissions'.[68]

Committee view

5.63 The committee believes that the bans on commissions for insurance inside superannuation provide important consumer protections.

5.64 The committee is mindful of the prediction that life-risk insurance will be the product most likely to provide advisers with commissions. It therefore recommends that ASIC conduct shadow shopping exercises post-implementation of the Bill to monitor whether conflicted advice is being provided on risk insurance outside superannuation.

Recommendation 7

5.65 The committee recommends that the Australian Securities and Investments Commission (ASIC) conduct shadow shopping exercises on advice pertaining to life risk insurance outside superannuation post implementation of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. ASIC should report its findings back to this committee within two years of the date the Bill commences.

Remuneration for group life insurance inside superannuation

5.66 Group life insurance is commonly understood as a structural arrangement where insurance is purchased from a life company by a trustee of a superannuation fund on behalf of a group or class of members to provide administrative and cost benefits for trustees and their members.[69]

5.67 A number of submitters argued that remuneration for the sale of group life policies within superannuation should be allowed on the basis that tailored advice is

67 Joint Consumer Groups, *Supplementary Submission 25*, p. 8.

68 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 59.

69 Financial Planning Association, *Submission 62*, p. 20.

provided in these instances.[70] CSSA argued that group life insurance 'is not unadvised insurance, as has been suggested'.[71]

5.68 The table below compares the features of insurance inside and outside superannuation. It highlights that insurance offerings in superannuation provide administrative efficiencies for superannuation funds and allows members to access group premium rates. It also offers the flexibility of Successor Fund Transfers (SFT).

Table 6.1: Comparison of the features of insurance inside and outside super

<table>
<tr><th colspan="2">GROUP OFFERING IN SUPERANNUATION</th><th rowspan="2">INDIVIDUAL OFFERING IN SUPERANNUATION</th></tr>
<tr><th>Default/MySuper</th><th>Choice/Group</th></tr>
<tr><td>• Employer/adviser determine cover design
• Member is defaulted/provided cover automatically
• Members may opt-out at any time</td><td>• Adviser/member determine cover design (e.g. product types, sum insured)
• Member actively chooses to take up cover
• Member can cancel policy at any time</td><td>• Adviser/member determine cover design (e.g. product types, sum insured)
• Member actively chooses to take up cover
• Member can cancel policy at any time</td></tr>
<tr><td>FoFA Bill - commission cannot be paid</td><td>FoFA Bill - commission cannot be paid</td><td>FoFA Bill - commission can be paid</td></tr>
<tr><td colspan="2">• Trustee is the owner of the policy
• Administrative efficiency for super fund
• Insurer covers the 'group of members'
• Members can access group premium rates (i.e. lower than individual rates)
• Super fund can Successor Fund Transfer (SFT) entire insurance offering
• Super fund can update and improve insurance offering as appropriate without the need for members to change policy</td><td>• Trustee is the owner of the policy
• Super fund administration is less efficient
• Insurer only offers member individual premium rate (i.e. higher cost)
• SFT limited because super fund cannot amend the individual insurance contracts
• Members must 'switch' policy themselves</td></tr>
</table>

Source: Financial Services Council, *Submission 58*, p. 57.

5.69 The Financial Planning Association (FPA) suggested that commissions on group life insurance should be allowed in the following instances:

70 ANZ Wealth, *Supplementary Submission 29*, pp 8–9; Corporate Superannuation Specialist Alliance, *Submission 30*, p. 3; Mr Brian Williams, iFinancial Solutions, *Submission 33*, pp 3–4; Moneywise Global Pty Ltd, *Submission 41*, p. 2; Matrix Planning Solutions, *Submission 42*, p. 5; FYG Planners Pty Ltd, *Submission 50*, p. 2; Financial Services Council, *Submission 58*, pp 54–55; Financial Planning Association, *Submission 62*, p. 20; Mr Robert Ross, *Submission 68*, p. 2.

71 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 78.

- if a client actively seeks personal advice which results in the purchase of a group life insurance policy inside superannuation in order to access the advantage of the group life policy rate as an individual; and
- if a client seeks personal financial advice to review and top up their insurance needs where it relates to a group life insurance arrangement inside superannuation (the commission should only be payable on the increase of life insurance cover and not from all members of the group-life arrangement).[72]

5.70 Westpac agreed that 'group life policy' should be amended to only capture situations where the product provides a pre-determined level of cover to the client (without tailored advice) and suggested an additional amendment that:

> ...in order to obtain insurance cover, the member must make a separate application for coverage under the product, including choosing the benefits and levels of cover.[73]

5.71 CSSA suggested an alternative remuneration model should the proposed ban on group insurance within superannuation proceed. CSSA further proposed that when insurance services are provided to an employer group, that a fee can be charged to all members at an agreed percentage as negotiated with the client.[74] Without this agreement in place, the default fee should be set to zero, to protect against firms charging a default commission even when advice is not provided.[75]

Regulatory arbitrage

5.72 As well as highlighting that tailored advice can be provided for group life insurance inside superannuation, 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.[76]

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72 Financial Planning Association, *Submission 62*, pp 20–21.

73 Westpac Group, *Submission 64*, p. 32.

74 Corporate Superannuation Specialist Alliance, *Submission 30*, p. 3.

75 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 82.

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

5.73 The AFA also argued that the Bill will create two different playing fields:

> ...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 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.[77]

5.74 The committee discussed the potential for regulatory arbitrage is relation to group life insurance with the Association of Superannuation Funds of Australia. It noted that 'wherever you have regulatory arbitrage it will drive behaviours'. Further:

> 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.[78]

5.75 In relation to risk insurance within superannuation, the Association commented:

> 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.[79]

5.76 Treasury outlined that the banning of commissions inside superannuation is consistent with the recommendation of the Super System Review (the Cooper

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

78 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 24 January 2012, p. 13.

79 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 24 January 2012, p. 13.

Review) as these commissions have the potential to affect the quality of advice. It also noted that ASIC shadow shopping surveys have indicated that in cases of poor advice, over half involved poor life insurance advice.[80]

5.77 Treasury informed the committee, however, that the government is still considering whether group life insurance should be treated in the same manner as individual risk insurance policies. Treasury commented that:

> It is not individually-advised versus group; it is individually-written policies versus group policies.
>
> The argument that has been put to government is that there is some individually-advised insurance within a group policy context and that that should be treated in the same way as individual policies.[81]

5.78 However, Treasury indicated that the government has yet to come to a conclusive view and the matter is still under discussion.[82]

Committee view

5.79 The committee does not accept a blanket statement that personal advice is provided to members on all group life insurance offerings. However, it does recognise that there are instances where tailored advice is provided on group life insurance and therefore it may be inequitable to allow for benefits to be paid on risk insurance outside superannuation. This may create market distortions and affect the quality of advice provided to consumers. One possible outcome, for example, is that it could deter advisers from offering group life insurance (which may have a discounted wholesale rate) over offering risk insurance outside superannuation where they will receive a commission. The committee considers this would be a poor outcome.

Recommendation 8

5.80 The committee recommends that post-implementation, Treasury work with the Australian Securities and Investments Commission (ASIC) to monitor closely the quality of advice on the sale of risk insurance inside and outside superannuation and any market distortions that may occur.

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80 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'How does the ban on conflicted remuneration apply to risk insurance?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

81 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p. 63.

82 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 63.

Asset-based fees on borrowed amounts

5.81 The Bill establishes a ban on asset-based fees (a fee calculated as a percentage of a client's funds under advice) on borrowed amounts.[83]

5.82 A 'borrowed amount' refers to an amount borrowed in any form, secured or unsecured. An exemption is provided if it is not reasonably apparent to the licensee or adviser that the monies used by a retail client are borrowed. The EM states that the test for 'whether something is "reasonably apparent" is an objective one, based on whether it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice, exercising care and assessing the client's information objectively'.[84] The Bill will establish such an offence, as subject to maximum civil penalties of $200,000 for an individual or $1,000,000 for a body corporate. Treasury commented that the rationale for the measure:

> ...is to prevent advisers from artificially inflating their advice fee by recommending a client borrow additional funds (inappropriate borrowing strategies were a key concern arising out of the collapse of Storm Financial).[85]

5.83 The FPA submitted that asset-based fees should not be considered conflicted remuneration where they act against a client's interest as it is a form of 'calculating' remuneration:

> ...to equate "asset based fees" with "conflicted remuneration" shows a profound (or potentially deliberate) misunderstanding of the fact that ‘asset based fees' are not a form of remuneration at all, but very simply a form of 'calculating' remuneration. When coupled with the professional expectations that require client directed payment and prohibit product or strategy bias that act against a client’s interest, it is clear that this form of calculation does not create conflict at all.
>
> The issue that should be debated is not which calculation model is permissible for borrowed amounts, but whether the remuneration in the financial planning profession is respondent to professional expectations of practice, transparency and comparability and more than anything else, aligned to professional expectations of a service that delivers value.[86]

5.84 The FPA suggested that the ban on asset-based fees on geared funds should be removed as it is 'disingenuous to the benefit that a statutory best interest duty obligation will provide' and that the best interest duty 'will assist in driving the

83 Treasury, *Submission 22*, p. 9.

84 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, *Explanatory Memorandum*, p. 37.

85 Treasury, *Submission 22*, p. 9.

86 Financial Planning Association, *Submission 62*, p. 25.

behavioural change needed to address this issue'.[87] Burrell Stockbroking and Superannuation (BSS) also suggested that the 'best interest duty' is sufficient to protect consumers in relation to gearing:

> In order to manage risk, clients who use borrowed funds for investment purposes need a higher level of advice than clients who invest their own funds. We advise clients who borrow funds for investment to operate a low risk strategy, such as investing only in blue chip stocks. Removing the ability to charge asset-based fees on borrowed funds will diminish the level of advice provided to clients who borrow. It is essential that clients who borrow continue to access professional advice to manage their risk. The Bill should reconsider the ban on charging asset-based fees on borrowed funds.
>
> Placing a ban on asset-based fees on borrowed funds is not the way to stop over gearing, the like of which lead to the Storm Financial collapse. If an adviser has correctly and diligently obtained a client's information and objectives, then appropriate advice would mean a client is not over geared... It is our opinion that the 'best interest duty' would be sufficient to ensure gearing is controlled.[88]

5.85 FPA suggested that the following circumstances should be explicitly excluded from the bans on asset-based fees:

- where the financial planner is not responsible for, and has not recommended, the client borrow to invest (the gearing). For example, the client already has geared funds and requests an investment strategy from the financial planner; and
- an existing client has a geared portfolio prior to the commencement of the Bill, and 'tops up' the gearing for further investment opportunities following the commencement of the Bill.[89]

5.86 Mr Russel Tym, a submitter to the inquiry, suggested that the measure will deter clients from using borrowing strategies as the ban will force advisers to move to alternate remuneration structures, and charge large initial fees to assist consumers to set up their savings plans.[90]

5.87 Treasury argued that the measure allows advisers to recommend a borrowing strategy if it is in a client's best interest and that advisers are able to use alternative remuneration methods in these instances:

> The measure does not prevent advisers from recommending borrowing strategies to clients, especially if such a strategy is in a client's best interests. However, the adviser would need to find an alternative method to

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87 Financial Planning Association, *Submission 62*, pp 25–26.

88 Burrell Stockbroking and Superannuation, *Submission 11*, p. 7.

89 Financial Planning Association, *Submission 62*, p. 26.

90 Mr Russel Tym, *Submission 40*, p. 3.

charge for advice on the borrowed component. For example, the adviser could charge an hourly rate or a flat fee which is not percentage-based.[91]

5.88 ISN supported the provision, and opposed the deduction of any form of asset-based or ongoing fees. It suggested that permitting them 'enables the industry to replicate all the ill-effects of commissions'.[92] The JCG agreed and suggested that the restrictions on asset-based fees should be widened,[93] particularly as the EM outlines that asset-based fees are likely to become more prevalent after implementation of the Bill.[94] The JCG also asserted that asset-based fees mimic the features of commission remuneration:

> Firstly, they create conflicts of interests or incentives that may encourage the adviser to give poor quality advice. They bias advice away from strategic advice, such as personal debt reduction, towards recommendations to acquire products from which an adviser can extract an asset-based fee. They do not provide an incentive to provide ongoing services to the client because the financial adviser is paid regardless of the services provided. Secondly, they are frequently not transparent to clients as they often involve the payment of fees out of funds under the control of the adviser, without any direct involvement by the client...Finally, asset-based fees bear no relationship to the work actually done by the financial adviser...
>
> These inherent flaws in asset-based fees often lead to excessive fees for financial advice. Research conducted by Rice Warner Actuaries in May 2011 indicates that the cost of advice provided by an adviser who uses a commission or asset-based fee remuneration model is 3 to 18 times the cost of similar advice provided by an adviser who uses a fee-for-service remuneration model. The higher fees paid by clients whose advisers use a commission or asset-based fee remuneration model will obviously erode the wealth of these clients.[95]

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91 Treasury, *Submission 22*, p. 9.

92 Industry Super Network, *Submission 12*, p. 2; see also Joint Accounting Bodies, *Supplementary Submission 23*, pp 5–6.

93 JCG requested that the Bill be amended to ensure that a licensee, or its representative, 'must not charge an asset-based fee for financial product advice if borrowed funds have been, are or will be used to acquire financial products by or on behalf of the client to which the financial product advice relates' and that asset-based fees be permissible only if all borrowed funds have been repaid at the time the fee is charged.
Joint Consumer Groups, *Supplementary Submission 25*, pp 10–11.

94 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 49.

95 Joint Consumer Groups, *Supplementary Submission 25*, pp 9–10.

Burden of proof that money is not borrowed

5.89 Westpac commented that the burden of proof under the 'reasonably apparent' that money is not borrowed test would be costly and onerous for both the product provider and the customer:[96]

> Given that many customers set up instructions when they first invest, and often make additional investments electronically (e.g. BPAY or direct debit), ascertaining each and every time if the investment is from borrowed funds is near impossible and very inefficient.[97]

5.90 Westpac suggested the inclusion of a specific exemption for product providers that are simply facilitating the payment of adviser fees through the product.[98]

Committee view

5.91 The committee notes that under the FOFA reforms, consumers can continue to use borrowing strategies where it is in their best interest: in this case, the adviser can charge a fee for service.

Grandfathering provisions

5.92 The Bill has provisions on the application of the ban on conflicted remuneration where benefits 'given under an arrangement entered into before the day on which that item commences' do not apply.[99] Minister Shorten announced in August 2011 that:

> The ban on conflicted remuneration (including the ban on commissions) will not apply to existing contractual rights of an adviser to receive ongoing product commissions.
>
> This means that, in relation to trail commissions on individual products or accounts, any existing contract where the adviser has a right to receive a trail commission will continue after 1 July 2012, or in the case of certain risk insurance policies in superannuation, 1 July 2013.[100]

5.93 The grandfathering provision (or 'application of ban on conflicted remuneration' as stated in the Bill) is conditional on:

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96 Westpac Group, *Submission 64*, p. 29.

97 Westpac Group, *Submission 64*, p. 29.

98 Westpac Group, *Submission 64*, p. 30.

99 *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, s1528.

100 The Hon. Bill Shorten, MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms – Draft Legislation', *Media Release 127*, 29 August 2011.

a) The benefit is given under an arrangement entered into before the day on which that item commences; and

b) The benefit is not given by a platform operator.[101]

5.94 The AFA and the FSC argued, however, that what is proposed and what has been delivered are different.[102] The ABA argued the case for clear grandfathering provisions to be included in the Bill:

> 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.[103]

5.95 The FSC noted that paragraph 1528(1)(b), which details the ban on conflicted remuneration, does not apply where 'the benefit is not given by a platform operator'. It argued that this 'amounts to a retrospective ban on conflicted remuneration paid by platforms' and 'is inconsistent with all previous policy announcements on this matter':

> The FSC recommends that s1528(1)(b) of Bill 2 be deleted to enable existing contractual arrangements to be grandfathered. The FSC also recommends that the Bill be amended to enable grandfathered benefits to also be accepted by a financial services licensee, authorised representative or representative of a financial services licensee.[104]

101 *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, ss 1528(1).

102 Association of Financial Advisers, *Submission 66*, p. 12; Financial Services Council, *Submission 58*, pp 51–52.

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

104 Financial Services Council, *Submission 58*, p. 52.

5.96 Treasury commented that the FOFA reforms 'will have a substantial impact on industry and the grandfathering of existing contracts will mean that the changes will apply on a more gradual basis'.[105]

Committee comment

5.97 The committee has requested a response from Treasury as to why section 1528(1)(b) has been included where grandfathering is not given when 'the benefit is not given by a platform operator'. The committee asked Treasury to comment on this issue in light of arguments that this does not align with the government's policy intention. Although the committee had not received a response before finalising its report, it is important that Treasury does explain this issue on the public record.

Technical amendments and 'drafting anomalies'

5.98 The committee notes that a number of industry members raised concerns that the Bills contain drafting anomalies relating to conflicted remuneration issues and have recommended drafting amendments for the Bill.[106]

5.99 Mr Jim Murphy, Executive Director of the Markets Group of Treasury has highlighted the difficulties of providing industry with concrete certainty in regulatory material during major reforms:

> In relation to the views expressed here by industry yesterday—I know these people personally, I have worked with them for a long time, and I have a very high regard for the representatives of some of these industry organisations and for some of the major institutions—these are challenging reforms for industry, and industry of course, where they have businesses to run, will look for concrete certainty in legislation and explanatory material. I suggest to the committee that it is very difficult or probably not possible to give concrete certainty as to how things will work out in terms of legislation. What we have to do is to provide as much guidance and explanation as possible to the industry through the bill, the explanatory material and ASIC's explanatory notes.[107]

105 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'Why weren't commissions banned retrospectively?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

106 Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 5; Financial Services Council, *Submission 58*; Law Council of Australia, *Submission 62*; Westpac Group, *Submission 64*; Australian Bankers Association, *Submission and Supplementary Submission 67*.

107 *Committee Hansard*, 24 January 2012, p. 58.

Committee comment

5.100 In addition, the uncertainty of industry members in relation to conflicted remuneration was acknowledged by a Bills Digest released by the Parliamentary Library. The committee agrees with the commentary in the Bills Digest that ASIC has an important role to play in clarifying issues and allaying stakeholder concerns.[108]

5.101 The committee notes that the Bills represent major reform of the financial services sector and perhaps the most significant reforms in the last decade.[109] As with any major reform, there will be some uncertainty for stakeholders in the way in which legislation will be interpreted and how industry participants should apply the new laws. With this in mind, Treasury and ASIC should ensure that any uncertainty is addressed and further clarity be provided wherever possible.

108 Margaret Harrison-Smith, Parliamentary Library, 'Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011', Bills Digest No. 96, 2011-12, p. 11.

109 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 58.

Chapter 6

Volume based fees and anti-avoidance provisions and soft-dollar exceptions

6.1 A number of submitters expressed concern that some industry players have moved to vertical integration structures to avoid the bans on volume-based payments. This chapter discusses these views and the proposed anti-avoidance provisions contained in the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 designed to address these activities.

6.2 The bans on soft-dollar benefits will also be discussed, including concerns that some legitimate forms of professional development will be banned. Submitters' views on the proposal to limit professional development benefits to within Australian and New Zealand are also canvassed.

Volume-based shelf-space fees

6.3 Currently, employers can pay incentives to advisers to sell a certain type or a certain volume of products. The Bill proposes to prohibit:

- volume-based shelf-space fees paid by funds managers to platform operators; and
- volume payments from platform operators to financial advice dealer groups.[1]

6.4 The Explanatory Memorandum (EM) outlines that volume-based incentives deemed to be conflicted remuneration include benefits which are dependent on the value of financial products of a particular class recommended or required and the number of financial products of a particular class recommended or acquired.[2] The EM states:

> In an industry as complex and fast-evolving as the financial services industry, there are and will always be a wide range of remuneration arrangements. However, volume-based payments of the kind described in section 963L appear on the face of it to be inherently conflicted, since the financial adviser will have a financial incentive to maximise the value of

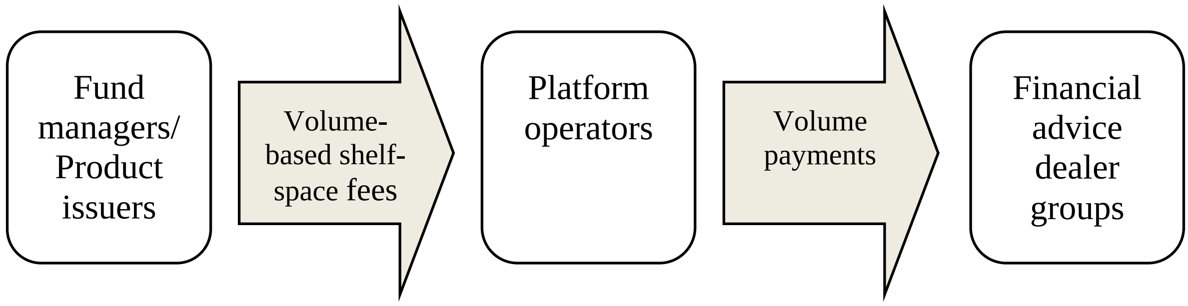
1 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 7, 25.

2 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 27.

the payments irrespective of the suitability of the products or investments for the client.[3]

6.5 Diagram 6.1conceptualises the interactions between product issuers, platform operators and financial advice dealer groups. It demonstrates, in a simplified form, the benefits offered, and received, between these parties.

Diagram 6.1: current structure of volume-based rebates



Source: Committee secretariat, adapted from *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 7, 25; Treasury, *Submission 22*, pp 8–9; Jennifer McDermott, 'What's that: Shelf-space fees', *The Australian*, 9 June 2010.

6.6 The term 'shelf-space fees' is derived from the retail grocery industry where a manufacturer may pay more for its product to receive greater prominence in a store. In the context of financial products, shelf-space fees refer to the levies paid by manufacturers (typically managed funds) to have preferential treatment for their product when listed on a menu of products accessed by financial advisers on behalf of their clients.

6.7 The lists of products are generated by platform operators (or investor directed portfolio services) which 'can also be thought of as a one-stop shop or virtual supermarket for managed funds and other financial instruments'.[4] Treasury defines a platform operator as:

> ...a financial services licensee or RSE licensee (as defined in the *Superannuation Industry (Supervision) Act 1993* ('SIS Act')) that offers to be the provider of a custodial arrangement. 'Custodial arrangement' is defined in the existing section 1012IA of the Corporations Act; broadly, it is an arrangement where the client may instruct the platform to acquire certain financial products, and the products are then either held on trust for the client, or the client retains some interest in the product. Under this definition, it is taken to include arrangements where the client may direct the platform to follow an investment strategy of the kind mentioned in the SIS Act.[5]

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3 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 27.

4 Jennifer McDermott, 'What's that: Shelf-space fees', *The Australian*, 9 June 2010.

5 Treasury, *Submission 22*, pp 8–9.

Vertically integrated models

6.8 A number of submitters voiced concerns that some adviser groups will move to vertically integrated models to avoid the bans on volume-based payments. Professional Investment Services (PIS) suggested that the ban on volume-based remuneration creates an anti-competitive environment as the provision targets non-vertically integrated models and overlooks vertically integrated models including in-house or proprietary products. PIS commented that in this scenario the profit may pass over the adviser/licensee, yet is still retained within the broader group of associated companies. There is, therefore, still the capacity for conflicted advice:

> The revenue, and source of profits, may sit in different entities however the capacity to influence financial product advice is arguably far greater in a vertically integrated model.
>
> A non-vertically integrated model may have a much broader range of products and platforms to choose from, than vertically integrated models. In such an environment, where there is broad product choice, and the adviser receives no benefit from recommending one product over another, where does the conflict arise? In an environment where there is a narrow APL filled with proprietary product, which is associated with the Licensee or the Licensee's parent company, and the adviser has an extremely limited product choice to recommend from, how great is the capacity to conflict advice?[6]

6.9 Associated Advisory Practices (AAP) offers compliance and business development services to independently owned Australian Financial Services License (AFSL) holders. AAP were concerned similarly that volume rebates will result in an anti-competitive environment and argued that leading banks will hold considerable advantage over smaller players:

> Banks and institutions operate vertically integrated business models [and] therefore have considerable scale and distribution advantages, and the advent of FoFA will see an expansion of these advantages. While views on the impact of these proposals diverge, the reality for independents, boutiques and smaller dealer groups is that these measures will increase the cost of providing financial advice and reduce their capacity to operate profitable planning practices – at least on a level footing with the large players.[7]
>
> It should be emphasised that whilst we support the reforms to the extent that it aims to improve the trust and confidence of Australian retail investors in the financial planning sector, we are concerned that the uneven playing field under its proposed delivery will not only push many small

6 Professional Investment Services, *Supplementary Submission 17*, p. 9.

7 Associated Advisory Practices, *Supplementary Submission 20*, p. 2.

> players out, but may also result in pricing an important consumer segment out of the market- and it will ultimately be consumers who will suffer.[8]

6.10 PIS recommended that the prohibition against volume rebates from platform providers to licensees be reconsidered in recognition that potential conflicts can be effectively managed without the ban.[9] AMP Financial Services agreed that the broad ban on conflicted remuneration would be sufficient to ensure that shelf space payments would 'only be banned when they could reasonably influence the advice provided to retail clients'.[10]

Permissible volume-based rebates should pass on to consumers

6.11 The Industry Super Network (ISN) also acknowledged the propensity the ban creates for dealer groups to restructure and become de facto platform or product providers. The ISN argued, however, that volume-based rebates should be completely banned to address this issue, or only permitted in circumstances where the rebate is required to be passed through to the end consumer:[11]

> We also strongly disagree with the permissive treatment of volume rebates, which are in effect a wholesale commission paid to incentivise product recommendations. While notionally justified on the basis that they enable a platform to realise scale benefits, the proposed regulatory setting does not ensure that the end consumer benefits from the payment of a rebate. ISN submits that volume rebates should have either been completely banned, or that they should have been permitted only if required to be passed through to the end consumer. As predicted, there will be a number of dealer groups which develop creative structures to become de facto platform or product providers to retain volume based payments.[12]

6.12 Vanguard Investments Australia has also submitted that there is a need for a requirement to pass any volume-based benefits platforms received through to the end investor:

> ...even rebates that are considered by platforms and fund managers to reflect reasonable scale efficiencies may influence the product options that an adviser gets access to through platforms unless the cost benefit is delivered through to the end investor.[13]

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8 Associated Advisory Practices, *Supplementary Submission 20*, p. 3.

9 Professional Investment Services, *Supplementary Submission 17*, p. 10.

10 AMP Financial Services, *Submission 43*, p. 25.

11 A benefit is presumed not to be a volume-based shelf-space fee if it is proved that all or part of the remuneration is a fee for service or a discount that does not exceed the reasonable value of scale efficiencies (see Treasury, *Submission 22*, p. 9).

12 Industry Super Network, *Supplementary Submission 12*, p. 4.

13 Vanguard Investments Australia Ltd, *Submission 60*, p. 2.

6.13 Vanguard noted that some platforms currently do pass the benefit on to the consumer and that the Bill creates a risk that these practices may cease.[14]

6.14 In Macquarie Bank's view, the Bill *will* allow for volume-based payments to be passed on to the end consumer. Macquarie Bank believed that this activity is essential for a competitive environment between independent providers and vertically integrated suppliers:

> In Macquarie's view the ability to pass volume-based discounting of administration fees to fund members is a positive and essential feature of the tabled FOFA provisions...We consider that the ability to provide such discounts to fund members on this basis is essential for independent providers to be able to continue to compete with vertically integrated providers which will inevitably have flexibility in the pricing of their administration services.[15]

6.15 The Financial Services Council (FSC) recommended that section 964A (Platform operator must not accept volume-based shelf-space fees) be amended to exempt any benefit that is passed on in full to the end investor to be permissible:

> That is, any volume related benefit payment that flows from a fund manager via a product provider licensee such as a custodial arrangement, superannuation fund or managed investment scheme should be permitted if passed in full to the retail investor without having to prove the benefit met s963A(3)(b) scale efficiency test.[16]

6.16 The Superannuation Committee of the Law Council of Australia noted that some large superannuation funds negotiate favourable rebates that will exceed efficiency savings, and that these should be allowed, especially as 'superannuation trustees are required by law to hold all rebates for the benefit of their members and cannot retain those rebates for their personal benefit'. It recommended that trustees of superannuation funds should therefore be excluded from the definition of platform operators or an additional exception should be applied that allows for volume-based fees that are received for the benefit of the retail client. [17]

6.17 Treasury responded to a written question on notice from the committee which sought to clarify whether volume-based benefits could be passed on to the end consumer. Treasury stated that '[t]he Bill does not prohibit volume-based fee rebates that are not otherwise banned from being passed from the platform provider to the end consumer'.[18]

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14 Vanguard Investments Australia Ltd, *Submission 60*, p. 2.

15 Macquarie Bank Limited, *Submission 65*, p. 2.

16 Financial Services Council, *Submission 58*, p. 66.

17 Law Council of Australia, *Submission 55*, p. 12.

18 Treasury, answer to question on notice, 24 January 2012, (received 10 February 2012), p. 2.

6.18 The Australian Securities and Investments Commission (ASIC) acknowledged that the concept of volume-based shelf-space fees has not previously been considered by the courts, and will provide further guidance on how the provision will be interpreted in 2012. ASIC commented that it:

> ...will need to assess the effectiveness of these new provisions over time and in light of regulatory experience. However, to assist industry in adopting measures to comply with the FoFA reforms, ASIC will provide guidance on how we interpret this provision in 2012.[19]

Anti-avoidance provisions

6.19 The government is cognisant of the fact that some industry players intend to avoid various measures, in particular the ban on volume-based payments from platform providers to dealer groups.[20] The Boutique Financial Planning Principals Group (BFPPG) commented:

> A ban on volume rebates alone will not be effective and we have already seen larger dealer groups moving to protect their revenue base by becoming their own Responsible Entity and recommending their own products to retain the income that they would have received from volume rebates and that will now be banned.[21]

6.20 In response, the first tranche[22] of the FOFA reforms includes anti-avoidance provisions which 'prevents a person from entering into a scheme if the sole or dominant purpose of doing so was to avoid the application of any provision in Part 7.7A' (Best interests obligations and remuneration). Contravention of the anti-avoidance provision is subject to the standard maximum penalty of $200,000 for an individual and $1 million for a body corporate:

> If a fee recipient continues to knowingly or recklessly charge a client an ongoing fee after the termination of the relevant ongoing fee arrangement, the Court can make an order for the fee recipient to refund the fees to the client. However, a Court may only order the payment of a refund if it is reasonable in all the circumstances to do so. The Court may make the order on its own initiative, on application by ASIC or the client.[23]

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19 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 20.

20 The Treasury, *Future of Financial Advice: Frequently Asked Questions*, 'What happens to consumers who sign up to products between now and 1 July 2012 (commencement date of reforms)?' http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm (accessed 3 February 2012).

21 Boutique Financial Planning Principals Group, *Submission 48*, p. 7.

22 Corporations Amendment (Future of Financial Advice) Bill 2011.

23 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 16.

6.21 The second tranche[24] of the FOFA reforms amends the new anti-avoidance provisions to capture a broader range of schemes designed to avoid the application of the FOFA reforms. The amendment changes the determination of what constitutes an avoidance scheme from whether 'the sole or dominant purpose' of the scheme is avoidance, to whether avoidance is the sole or a non-incidental purpose of the scheme.[25]

6.22 The Law Council has recommended that the anti-avoidance provision be further amended to expressly state that the provision does not apply if the scheme was entered into on before a specified date. The Law Council is concerned that the provision would not apply just to a scheme entered into on or after 1 July 2012, but any scheme before that date also.[26]

Committee view

6.23 The committee believes that the anti-avoidance provisions of the future of financial advice reforms are adequate to address moves from advice dealer groups to use vertically integrated models to continue receiving volume-based shelf-space fees. The committee acknowledges that ASIC has undertaken to provide further guidance on how the provision will be interpreted and the committee await with interest this guidance.

Soft-dollar benefits

6.24 Soft-dollar benefits are non-monetary benefits within the definition of conflicted remuneration that could 'reasonably be expected to influence financial product advice'.[27]

6.25 The Bill provides exceptions for the ban on conflicted remuneration for soft-dollar benefits under the amount prescribed by regulation (proposed to be $300). It also provides an exception for soft-dollar benefits with an education or training purpose and soft-dollar benefits that provide information technology software or support.[28]

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24 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

25 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 38.

26 Law Council of Australia, *Submission 55*, p. 13.

27 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

28 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 24.

Claims that legitimate forms of professional development will be banned

6.26 The Financial Planning Association of Australia (FPA) and Westpac submitted that the provisions do not consider the importance of educational services that go beyond financial product advice such as practice management, general economic information and client relationship skills.[29] Westpac recommended that the exemption needs to be broadened to 'allow for legitimate education and training which does not influence advisers to recommend a particular product'.[30]

6.27 The ABA also raised concerns in relation to the Bill's reference to professional development being relevant to subparagraph 963C(c)(ii), the provision of 'financial product advice'. It argued that this provision will lead to uncertainty regarding the range of topics that could be covered at professional development events and that financial advisers engage in activities beyond simply 'giving financial product advice', such as dealing and administrative activities including marketing, accounting, business strategy, and OH&S.[31]

6.28 FSC argued that the relevance test in subparagraph 963C(c)(ii) should be omitted and that the requirement for the benefit to have a genuine education or training purpose and to comply with the regulations would be sufficient. FSC suggested that any concerns about particular types of training should be addressed in regulations:[32]

> 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.[33]

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29 The Westpac Group, *Submission 64*, p. 27; Financial Planning Association, *Submission 62*, p. 22.

30 The Westpac Group, *Submission 64*, p. 27.

31 Australian Bankers' Association, *Submission 67*, p. 38.

32 Financial Services Council, *Submission 58*, p. 82.

33 Financial Services Council, *Submission 58*, pp 82–83.

6.29 FSC recommended that subparagraph 963C(c)(ii) be omitted or redrafted to read 'the benefit is relevant to the provision of financial services or to the conduct of a financial services business'.[34]

Information technology software and support

6.30 Subparagraph 963C(c)(ii) also applies to non-monetary benefits in the form of IT support and software 'that are related to the provision of financial product advice and that comply with any other requirements detailed in the regulations'.[35]

6.31 The Joint Consumer Groups (JCG) argued that the carve-out for IT software or support is too broad, and should be limited:

> It covers software or support services that are 'related' to advice in relation to the product provider’s products. 'Related' is a very broad concept and, therefore, as currently drafted, the carve-out might allow the provision to financial advisers of, for example, Microsoft Office, expensive practice management and advice expert software like COIN which is not product or platform specific.[36]

6.32 The JCG suggested that the Bill and EM be amended to specify that the carve-out does not apply to standard IT software and only to software relevant to a specific financial product:

> The carve-out for information technology software or support provided by product providers, in s963C(d), should be modified so that s963C(d)(ii) reads ‘the benefit is essential to the provision of financial product advice in relation to the financial products issued or sold by the benefit provider.’ The Explanatory Memorandum should further explain that this carve-out does not allow the provision of standard information technology software and support necessary for the operation of any financial advice business but, instead, is intended to allow the provision of information technology software and support that is essential to allow sales of, or advice in relation to, a specific product.[37]

6.33 Treasury have provided the following table that outlines when commercial software is intended to be banned.

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34 Financial Services Council, *Submission 58*, pp 82–83.

35 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

36 Joint Consumer Groups, *Supplementary Submission 25*, p. 6.

37 Joint Consumer Groups, *Supplementary Submission 25*, p. 8.

Table 6.2: Some examples of the operation of the ban (not exhaustive)

Issue	Banned?	Why?
Free or subsidised business equipment or services, such as computer hardware, office rental and commercial software, over $300.	Yes	These benefits have the potential to influence product selection and decision making.
Access to administrative information technology services, such as software to access a platform or access to a website to place orders.	No	So long as it can be shown that the administrative information technology services is relevant and tangible to the licensee's business, this is a benefit that will be permitted as it facilitates access to advice.

Source: Adapted from Treasury, Future of Financial Advice Frequently Asked Questions, 'Why has the Government decided to ban soft-dollar benefits and what is included in the ban?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

Committee view

6.34 The committee recognises that subparagraph 963C(c)(ii) creates potential for some legitimate forms of education to be considered as conflicted remuneration under the provisions of the Bill. However, the committee also recognises the counter argument, that if the carve-out for soft-dollar benefits were to be broadened, it could include non product or platform specific support such as the Microsoft suite. To overcome this concern, the committee considers that further explanation of legitimate forms of education should be provided.

Recommendation 9

6.35 The committee recommends that further material be provided in the Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 to outline examples of legitimate training, such as practice management or client relationship skills. Legitimate forms of training should also be provided in the regulations.

Dollar limit

6.36 The EM outlines that 'benefits under the amount prescribed by regulations (proposed to be $300), [will not be regarded as conflicted remuneration] so long as those benefits are not identical or similar and provided on a frequent or regular basis'.[38]

38 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 31.

6.37 The FSC and the ABA are concerned that there is uncertainty in determining when a benefit is provided on a 'frequent or regular' basis and recommended that this be clarified in the EM.[39] FSC argued:

> While we do not believe it is appropriate to define these terms in the legislation. We recommend that the EM should be amended to include examples of what is and is not deemed to be "frequent or regular" for clarity purposes.
>
> For example, we would determine that taking a representative out to lunch once a year would not be "frequent or regular", but acknowledge other interpretations may exist and seek confirmation via an amendment to the EM that this example is not frequent or regular.
>
> Conversely, we acknowledge that taking a representative out to lunch once a month is likely to be interpreted as both frequent and regular.[40]

6.38 The committee agrees that there is a need for greater clarity in relation to this matter.

Recommendation 10

6.39 The committee recommends that the Explanatory Memorandum for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended to provide clarity on the application of the $300 limit for soft-dollar benefits. Further, the committee recommends that examples of what is and is not deemed to be 'frequent or regular' should be stated in the Explanatory Memorandum and the regulations.

Overseas professional development

6.40 As part of the non-monetary conflicted remuneration measures, it is proposed that professional development and training will be restricted to that which is conducted within Australia and New Zealand. This includes a 'majority time requirement' where 75 per cent of the time during a standard 8 hour day is spent on professional development. Further, that any travel costs, accommodation and entertainment outside the professional development activity be paid for by participants.[41]

6.41 While the majority of submitters are in support of the measures to allow genuine education or training as a form of remuneration, many submitters did not

39 Financial Services Council, *Submission 58*, p. 82; Australian Bankers Association, *Submission 67*, p. 38.

40 Financial Services Council, *Submission 58*, p. 82.

41 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 31.

agree with the domestic requirement.[42] PIS argued that this measure will 'seriously undermine professional development' of advisers and the industry as a whole.[43] PIS went on to state:

> Such a prohibition will considerably restrict Australian financial services professional’s cross-jurisdictional education, and development as well as significantly hampering domestic innovation and development. From an educational and content perspective, it is also important to highlight the rationale for holding conferences on an international basis is often driven by increasing exposure to highly regarded international speakers which are not available domestically. Given the geographical distance and separation between Australia and the U.S or Europe, access to international speakers is often not attainable unless conferences are arranged internationally.
>
> Limiting the professional development exemption to domestic basis will significantly undermine Australia's international financial services exposure and is inconsistent with the government's objectives of promoting Australia as a financial services hub.[44]

6.42 IOOF Holdings suggested that the domestic requirement restriction be extended to the Asia-Pacific region. It also highlighted that many larger licensees will have overseas commitments for professional development activities planned at least 18-24 months in advance. These activities may include potential liabilities if participants withdraw from contractual arrangements. IOOF Holdings submitted that in the event that the domestic requirement is passed by the parliament a minimum 2 year transition period apply.[45]

6.43 AMP Financial Services recommended that the criteria to determine whether professional development is genuine should be defined by the activity, rather than geography.[46] The EM notes that 'it is envisaged that there will be further consultation on the regulations' in relation to professional development and the domestic requirement.

Committee view

6.44 The committee considers that provisions restricting professional development benefits to Australia and New Zealand are too stringent and that professional development benefits should be based on the activity rather than its location.

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42 Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 4; IOOF Holdings Limited, *Submission 19*, p. 6; Associated Advisory Practices, *Submission 20*, p. 8; AMP Financial Services, *Submission 43*, p. 23; Financial Services Council, *Submission 58*, p. 83; Financial Planning Association, *Submission 62*, p. 23; Association of Financial Advisers Ltd, *Submission 66*, p. 15; Australian Bankers' Association, *Submission 67*, p. 39.

43 Professional Investment Services, *Supplementary Submission 17*, p. 3.

44 Professional Investment Services, *Supplementary Submission 17*, p. 14

45 IOOF Holdings Limited, *Submission 19*, p. 7.

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

Recommendation 11

6.45 The committee recommends that the proposed consultations on the regulations for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 include consideration of the potential impact of restricting soft-dollar benefits of professional development to within Australia and New Zealand.

6.46 The committee recommends that no geographical restriction be placed on professional development where it is professional development focussed on education and training.

Scrutiny of Bills

6.47 The Senate Standing Committee for the Scrutiny of Bills noted that subsection 963C(3) of the Bill allows for an exception for non-monetary benefits when 'the benefit complies with regulations made for the purposes of this subparagraph'. It also noted the types of regulations that will be included (as discussed above) are outlined in the EM (pages 31 and 32).

6.48 It has highlighted this subsection as part of its role to report to the Senate when it considers a Bill has 'inappropriately delegate[d] legislative powers'.[47] It suggests that the Senate consider whether this delegation of legislative power is appropriate.[48]

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47 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 1 of 2012*, 8 February 2012, p iii.

48 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 1 of 2012*, 8 February 2012, pp 7–8.

Chapter 7

The matter of carve-outs: basic banking, stockbroking and the timeshare industry

7.1 A number of submitters have requested further clarity on, and suggested amendments to, the existing carve-out for employees or agents of Authorised Deposit-taking Institutions (ADI) that are providing advice on basic banking products.

7.2 The proposed carve-out for stockbrokers, intended to be addressed in regulations, was also discussed. The need for the Bill to be amended so that the timeshare industry is precluded from the bans on conflicted remuneration was also canvassed. These matters are discussed below.

Carve-out for basic banking products

7.3 Treasury argued that the carve-out for basic banking products has been provided on the basis that provision of advice on basic banking products is deemed a low risk to consumer detriment:

> Basic banking products and general insurance are recognised as being simple in nature and are more widely understood by consumers. This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, exclusion from the obligation to give priority to the interests of the client more appropriately balances the benefits to consumers with the compliance costs to providers.[1]

7.4 The carve-out for employees or agents of an ADI that are providing advice on basic banking products is conditional on the agent not providing financial product advice on financial products other than basic banking products, either in combination with or in addition to advice provided on basic banking products.[2] The Bill defines a basic banking product as:

> (a) a basic deposit product;
>
> (b) a facility for making non-cash payments (see section 763D) that is related to a basic deposit product;
>
> (c) an FHSA product of a kind mentioned in subparagraph (c)(i) of the meaning of FHSA in section 8 of the First Home Saver Accounts Act 2008 (first home saver accounts);
>
> (d) a facility for providing traveller's cheques;

1 Treasury, *Supplementary Submission 22*, p. 5.

2 Treasury, *Submission 22*, p. 8.

(e) any other product prescribed by regulations for the purposes of this paragraph.[3]

7.5 Treasury outlined that the bans are not intended to target sub-sections of the industry:

> The ban on conflicted remuneration structures is not designed to target certain industries, or sub-sections of the financial advice industry. The focus of the ban is removing conflicts of interest that may cause bias, or the potential for bias, in financial advice due to payments from product providers to those providing advice.[4]

7.6 The Australian Securities and Investments Commission (ASIC) divides banking products into Tier 1 and Tier 2 (see Table 7.1). ADI employees that offer advice on the lower level Tier 2 products may receive lower levels of training than those that advise on Tier 1 products.

Table 7.1: Tier 1 and Tier 2 products

Products		
Tier 1	All financial products except those listed under Tier 2	
Tier 2	•	General insurance products except for personal sickness and accident (as defined in reg 7.1.14) Note: Travel insurance products and included in Tier 2, even where the product covers losses arising due to sickness or accident while travelling
	•	Consumer credit insurance (as defined in reg 7.1.15) Note: Consumer credit insurance products are included in Tier 2, even where the product covers consumer credit liabilities that cannot be paid due to sickness or accident
	•	Basic deposit products
	•	Non-cash payment products
	•	FHSA deposit products Note: First Home Saver Account (FHSA) deposit accounts are FHSAs issued by an ADI. Other types of FHSAs are Tier 1 products: see RG 146.45-RG 146.46.

Source: Australian Securities and Investments Commission, *Regulatory Guide 146: Licensing: Training of financial product advisers*, December 2009, p. 17.

7.7 Abacus – Australian Mutuals welcomed the carve-out for ADI employees assisting consumers with basic banking products. However, it was concerned that the carve-out does not go far enough. Abacus argued that imposing any new regulations

3 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, s961F.

4 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'How will the ban on conflicted remuneration structures affect stockbrokers?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

on people who advise on basic banking products 'is a clear case of excessive coverage' and 'is likely to reduce the availability of advice to consumers'.[5]

7.8 The Australian Bankers' Association (ABA) suggested that the scope of the FOFA reforms should target identified market failures and 'should not impose unnecessary and inappropriate obligations on banks and banking groups'. The ABA recommended that the Bill reflect the stated policy intent[6] and the carve-out for basic banking products must be absolute:

> Regulation should target identified market failures. However, we are not aware of any identified market failures, consumer detriment or systemic concerns regarding practices by banks in the offer of basic banking products or the provision of general advice by bank staff. We consider that the legal risks, regulatory burdens and compliance costs that will be imposed on banks as a result of the broad scope of the FOFA legislative package are unnecessary and inappropriate.[7]

7.9 The ABA highlighted numerous legal and regulatory obligations 'to ensure banks are managed prudently' and bank products and services are transparent, accessible and delivered responsibly. It argued that the FOFA reforms will result in unnecessary compliance costs for banks which in turn will increase consumer costs. In addition, it argued that consumers may be adversely affected if banks withdraw the availability of 'simple' advice, general or 'scaled' advice in response to the FOFA reforms.[8] The ABA went on to state:

> ...banks that provide bank customers with financial advice may be required to restructure their business and/or alter their distribution model – this could result in no financial advice being provided through bank branches and call centres, and possibly result in a reduction of products and providers in the market. We consider this an undesirable outcome and would be contrary to the policy intent of the FOFA legislative package to broaden the availability of simple advice for consumers or for financial advice to be scalable to the needs of consumers as well as contrary to the efforts of the Government to ensure competition within the banking industry.[9]

7.10 The CEO of the ABA elaborated on this argument in his evidence to the committee:

> Given the training that is already required of bank staff, given their obligations under existing legislation, I do not see providing advice to a

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5 Abacus – Australian Mutuals, *Supplementary Submission 14*, p. 8.

6 There will be a limited carve-out from the ban on volume payments and best interests duty for basic banking products where employees of an Australian [authorised] Deposit-taking Institution (ADI) are advising on and selling their employer ADI basic banking products. (Future of Financial Advice Information Pack. Section 2.8. 28 April 2011).

7 Australian Bankers' Association Inc, *Submission 67*, p. 3.

8 Australian Bankers' Association, *Submission 67*, pp 2, 5.

9 Australian Bankers' Association, *Submission 67*, p. 5.

> customer who has come into the bank to go away and think about is necessarily a dangerous thing. In fact, one of our fears is of creating a situation where the customer walks into the bank branch and all the bank can say to them is 'Here's a form to fill in for a term deposit.' We know what customers are looking for in banks. One of the things banks are very conscious of is that customers sometimes feel we do not deliver a sense of it being a partnership between the customer and the bank where the bank can work with the customer to try and make the right decision. Our concern is that tellers and other bank staff are already under existing operations and adding these further obligations is just going to complicate things. In fact, we have already seen some banks pull out of providing anything that looks remotely like advice.[10]

7.11 ANZ Wealth argued that the Australian Prudential Regulation Authority (APRA) regulation of ADI remuneration policies is adequate, and further regulation of Tier 2 accredited employees is unnecessary:

> ANZ recommends that the second tranche legislation be amended to classify certain benefits given by an employer to an employee or contractor relating to the recommendation of any financial product as not being conflicted remuneration if the employee or contractor is only Tier 2 Accredited and the ADI can demonstrate that its risk and remuneration policies respond to the relevant APRA standards and guidance on remuneration. That is, existing APRA Prudential Standards provide adequate safeguards in respect of Tier 2 Accredited employees and contractors of banks, who are also subject to ASIC Regulatory Guide, and should therefore be carved out.[11]

7.12 ANZ also suggested that front-line banking staff should be entitled to remuneration for financial products other than basic banking products, and that a balanced scorecard approach to incentivising staff should be allowed as it provides appropriate safeguards against the mis-selling of products:

> Remuneration arrangements for frontline banking staff rewards out-performance while ensuring avoidance of inappropriate risk. This is done by utilising a balanced scorecard framework, aligned to role specialisation and capability, customer satisfaction and advocacy and a strong compliance management framework that includes risk gateways and where necessary reduction of or ineligibility for incentives for inappropriate behaviour. Even if an employee out-performs in relation to their financial metric, where value or volume based targets are used, they can still fall short of receiving an incentive payment if they have not met their other non financial performance objectives.[12]

10 Mr Steve Münchenberg, Chief Executive Officer, Australian Bankers' Association, *Committee Hansard*, 23 January 2012, p. 22.

11 ANZ Wealth, *Supplementary Submission 29*, p. 4.

12 ANZ Wealth, *Supplementary Submission 29*, p. 4.

7.13 ANZ noted that the EM 'appears to recognise the balanced scorecard approach as an acceptable remuneration arrangement'.[13] However, ANZ suggested that greater clarity is required on how 'it can be proved' that the remuneration could not 'reasonably be expected to influence' the advice.[14]

7.14 The ABA asserted that the terminology of 'reasonably be expected to influence' the advice is too subjective and that it 'should not be assumed that all incentive structures result in negative outcomes for consumers'. It argued that the conflicted remuneration definition should be limited to a negative influence and should only consider distortions to remuneration, which misalign the best interests of the client and the adviser.[15]

7.15 The Joint Consumers Group (JCG), however, opposed the carve-outs for ADIs. It claimed that there is no clear rationale for the carve-out of employees or agents of ADIs providing advice on basic banking products. Accordingly, the JCG argued that the carve-out should be removed:[16]

> The consumer representatives do not accept that the argument that basic banking products are simple, well-understood products justifies this carve-out. The consumer representatives note that (unlike insurance products) there is no need to encourage sales of basic banking products and that basic banking products, which can include term deposits of up to 5 years, can and have been mis-sold to consumers.[17]

Committee view

7.16 The committee believes that the carve-out from the conflicted remuneration bans for ADIs providing advice on basic banking products is sufficient to allow for current performance-based remuneration structures in ADIs to continue. However, the committee acknowledges requests from industry that further clarity be provided on how it can be proven that the remuneration could not 'reasonably influence' advice.

Recommendation 12

7.17 The committee recommends that the Australian Securities and Investments Commission (ASIC) provide regulatory guidance material on how Australian Authorised Deposit-taking Institutions (ADIs) can prove that remuneration does not 'reasonably influence' advice.

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13 See Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 28.

14 ANZ Wealth, *Supplementary Submission 29*, p. 4.

15 Australian Bankers Association, *Submission 67*, pp 22–23

16 Joint Consumer Groups, *Supplementary Submission 25*, p. 8.

17 Joint Consumer Groups, *Supplementary Submission 25*, p. 7.

General insurance

7.18 In contrast to ASIC's division of financial products, general insurance is not grouped within the list of basic banking products in the Bill (see table 8.1 above). The exception for ADI employees advising on basic banking products will not apply where advice on a non-basic banking product is provided in combination, or in addition to that advice. The EM outlines that the intent of this provision is to 'encourage customer service specialists, who wish to continue receiving volume of sales bonuses, to focus on providing advice on basic banking products only'.[18]

7.19 While general insurance is not subject to the broader ban on conflicted remuneration, Abacus expressed concern that precluding general insurance from the definition of basic banking products in the Bill creates a risk of unintended outcomes. In addition, it appears that an ADI employee providing advice about general insurance would become ineligible for the basic banking carve-out as advice on basic banking products cannot be provided in combination with other financial products. Abacus argued that in this case:

> It reduces consumer choice and diversity in retail financial services distribution and it has a direct impact on the potential earnings of frontline ADI staff. These ADI employees are not highly paid "financial planners". Customers will not wish to be referred to separate staff if they wish to talk about other simple products, such as general insurance, in addition to basic banking products.[19]

7.20 ANZ also noted that ADI employees will be unable to provide advice on general insurance products in conjunction with basic banking products. As a consequence, ANZ argued that this will have a detrimental outcome for consumers:

> If a bank employee is in the process of opening a transaction account for a customer and uncovers a need for building insurance to protect against natural disaster, the bank employee may need to refer the customer to a different member of staff to deal with the insurance matter. This would be required in order to preserve the "non conflicted remuneration" treatment of the basic banking product transaction. ANZ has a number of smaller branch sites where there would not be a different staff member to deal with the insurance matter.[20]

7.21 Abacus recommended that the ban on conflicted remuneration for ADI employees advising on basic banking products be amended to allow for advice categorised as Tier 2 in ASIC Regulatory Guide 146 (see Table 8.1 above).[21]

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18 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 33.

19 Abacus – Australian Mutuals, *Supplementary Submission 14,* p. 6.

20 ANZ Wealth, *Supplementary Submission 29,* p. 6, see also *Proof Committee Hansard*, 24 January 2012, pp 6–7.

21 Abacus – Australian Mutuals, *Supplementary Submission 14*, p. 6.

7.22 The ABA highlighted that banks provide an important 'one-stop-shop' for consumers on a variety of products that are regulated by an array of legislation including the Corporations Act and the *National Consumer Credit Protection Act 2009*. The ABA asserted that the restriction to provide advice 'solely' in relation to basic banking products presents difficulties, using general insurance as an example:

> Bank staff may provide information or advice to a customer on a basic banking product (e.g. savings account) and also on a non-basic banking product (e.g. general insurance product). Even though the general insurance product is carved out of the conflicted remuneration provisions, as currently drafted, the fact that the employee gave information or advice also on a non-basic banking product means this would result in the full best interests duty obligations applying and the employee not being able to receive an annual performance bonus or a payment relating to the offer of the basic banking product or the general insurance product.[22]

7.23 The ABA recommended that paragraph 963D(b) should be amended so that access to the benefit is dependent on the licensee/representative recommending a basic banking product, but *not solely* in relation to a basic banking product.[23]

7.24 ANZ asserted, however, that amendments to legislation or regulations to accommodate numerous products across the banking industry would be a complex approach. It requested that government consider a carve-out of superannuation products comparable to MySuper products prior to the MySuper start date of 1 July 2013.[24]

7.25 The ABA recommended that the EM be amended to define basic banking products to include other exempt products, such as general insurance and other exempt products made by regulations.[25]

Definition of 'basic banking product'

7.26 The ABA welcomed the ability to prescribe additional products as basic banking products by regulation.[26] However, it recommended that the EM be amended to broaden the exemption for basic banking products to include all types of at-call accounts, term deposit accounts (with a term less than five years), basic banking products offered along with other exempt products and non-financial products (for

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22 Australian Bankers' Association, *Submission 67*, p. 8.

23 Australian Bankers' Association, *Submission 67*, p. 8.

24 ANZ Wealth, *Supplementary Submission 29*, p. 7.

25 Australian Bankers' Association, *Submission 67*, p. 7.

26 The EM notes that the definition of basic banking product in the Bill 'provides flexibility to add additional products in the future if it is considered appropriate...given the constant rate of development in the financial product market'. *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 15.

example credit products) and financial services associated with the offer of basic banking products.[27]

7.27 Abacus voiced concerned that any effective narrowing in the category of deposits in the 'basic deposit product' will have significant implications for ADIs and consumers. Abacus noted that ADIs are the most highly regulated entities in the financial sector, and that deposits are the safest and simplest form of financial product.[28]

7.28 In November 2011, ASIC released *Consultation Paper 169: Term deposits that are only breakable on 31 days' notice: Proposals for relief*. Following the Basel III international liquidity reforms on the banking sector, term deposits that are only breakable on 31 days' notice could fall outside the definition of basic deposit product and therefore be considered a Tier 1 product. ASIC proposed relief for ADI requirements in relation to certain term deposits and whether they qualify as 'basic deposit products'. It claimed that term deposits of up to two years that can only be broken on 31 days notice should be subject to the same regulatory requirements as 'basic deposit products'.[29]

7.29 Abacus and the ABA recommended that the proposed relief for the basic product definition be clarified to include term deposits of up to two years where early withdrawal is at the discretion of the ADI. Further, it proposed that the definition of basic deposit product includes term deposits of up to five years, where early withdrawal is at the discretion of the depositor, with a notice of withdrawal period of up to 31 days.[30]

Consumer credit insurance

7.30 Consumer credit insurance (CCI) is a combination of life and general insurance under one insurance contract and is typically jointly issued by a life company and a general insurer. ANZ requested clarification on how CCI fits with the proposed exemptions, and whether it is deemed a general or a life insurance product. It requested that CCI be defined as being a general insurance product.[31]

7.31 The JCG argued that the Bill does not consider incentives for CCI as conflicted remuneration, noting 'strong reservations' about this decision. It highlighted recent studies showing cases of mis-selling of CCI where:

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27 Australian Bankers' Association, *Submission 67*, p. 7.

28 Abacus – Australian Mutuals, *Supplementary Submission*, pp 6, 8.

29 Australian Securities and Investments Commission, *Consultation Paper 169: Term deposits that are only breakable on 31 days' notice: Proposals for relief*, November 2011, p. 9.

30 Abacus – Australian Mutuals, *Supplementary Submission 14*, p. 8; Australian Bankers' Association, *Submission 67*, p. 8.

31 ANZ Wealth, *Supplementary Submission 29*, p. 7.

- consumers have not been aware that they have purchased CCI or that CCI is optional;
- consumers have not been asked whether or not they wish to purchase CCI;
- consumers have not been eligible to claim on all components of the CCI they have purchased;
- there has been potential for consumers to be pressured or harassed by sales staff; and
- consumers have not understood the cost or duration of the CCI policy. [32]

7.32 The JCG also noted that CCI commissions are significant:

> ASIC Report 256 found that commissions were close to 20% of the premium for the CCI product. It is probable that commissions are one of the drivers for such mis-selling. In light of this, the consumer representatives are concerned that the decision to allow financial advisers to continue to receive conflicted remuneration in relation to CCI is likely to lead to continued misconduct in relation to this product.[33]

7.33 The Insurance Council of Australia argued, however, that the ASIC report cannot be used as a case for CCI to receive differential treatment under the FOFA reforms:

> The ASIC review did not identify CCI remuneration practices as contributing to current sales practices and the report makes no recommendations in this regard. There is no basis within this report upon which to single out CCI for differential treatment in relation to conflicted remuneration.
>
> Furthermore, the proposal by the Joint Consumer Submission to subject CCI to a ban on conflicted remuneration would create inconsistencies with other insurance products of comparable complexity, particularly since CCI (along with almost all general insurance products) is considered a Tier 2 product for training purposes under ASIC's Regulatory Guide 146.
>
> We therefore submit that CCI should receive the same treatment under the FOFA reforms as that given to all other general insurance products.[34]

The committee's view

7.34 Noting the comments of ANZ and the JCG, the committee sought advice from Treasury about how CCI fits with the proposed exemptions from the Bill's conflicted remuneration provisions, and whether it is deemed a general or a life insurance product. Treasury responded that it is 'exploring this issue with industry'.[35] The

32 Joint Consumer Groups, *Supplementary Submission 25*, p. 7.

33 Joint Consumer Groups, *Supplementary Submission 25*, p. 7.

34 Insurance Council of Australia, *Supplementary Submission 39*, p. 4.

35 Treasury, answer to question on notice, 24 January 2012, (received 10 February 2012), p. 1.

committee considers that it is important that Treasury does provide guidance on this issue. It is also important that in determining whether to allow CCI an exemption from the Bill's conflicted remuneration provisions, careful consideration is given to the evidence that CCI has been mis-sold in the past and thereby poses a threat to consumer welfare if a ban is not applied.

Extending the carve out to non-ADI representatives

7.35 The FSC and AMP Financial Services suggested that the carve-out for basic banking products should not be limited to representatives of an ADI, and that the 'simplicity of the product and the advice should not be complicated by who is giving the advice'.[36]

7.36 Treasury argued that the carve-out is limited to ADIs as basic banking products are usually sold by ADI frontline staff, and consumers are aware that ADI's will be selling the employer's product:

> As these basic banking products are often sold by frontline staff, the carve-out is largely intended to address the more routine activities of frontline staff, such as tellers and specialists.
>
> While these employees may provide either general or limited personal advice in relation to these basic banking products, these products are generally easier for consumers to understand, and consumers more readily understand that the frontline employee of the ADI is in the business of selling the employer's product.[37]

Stockbroking carve-out

7.37 The EM refers to a carve-out that will be provided to exclude certain stockbroking activities from being considered conflicted remuneration, with the precise breadth of the carve-out being subject to further consultation.[38]

7.38 It is proposed that the receipt of 'stamping fees' from companies for capital-raising on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market.[39] Minister Shorten has stated:

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36 AMP Financial Services, *Submission 43*, p. 21; Financial Services Council, *Submission 58*, p. 77.

37 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'Why is there a carve-out for basic banking products?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_11 (accessed 3 February 2012).

38 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

39 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

'[w]here brokers undertake financial planning activities, the ban on product commissions will of course still apply, ensuring there is no gap in protection for consumers'.[40]

7.39 The Stockbrokers Association of Australia (SAA) noted that the intention is that there will be no material change for traditional stockbroking services under the FOFA reforms:

> For the traditional stockbroking service, buying and selling shares on the market, it appears that the carve-out means that there will be no material change. It will not be impacted unduly, I think the minister said. We are waiting for details of what that means. But in stockbroking there are a range of business models, as you would appreciate. Within large stockbroking firms with retail clients there are financial planning divisions. All of them have financial planners. So all of the issues facing financial planners which relate to buying and selling managed funds, conflicted remuneration, fee disclosure and opt-in will apply to stockbrokers in terms of the advice on those products.[41]

7.40 SAA commented, however, that it would seek clarification on whether the carve-out applies to both authorised representatives and employee stockbrokers.[42]

7.41 ANZ suggested that absolute clarity on the scale of the carve-out from conflicted remuneration as it applies to stockbroking should be included in the Bill and the EM in relation to the execution-only services exemption. It also recommended that 'Treasury develop with industry a comprehensive list of what specific stockbroking activities are considered capital-raising and are thus exempted'.[43]

7.42 Treasury informed the committee that issues pertaining to stockbrokers will be best addressed in the forthcoming regulations.[44] Treasury have provided an outline of some of the issues being considered in relation to stockbrokers:

> There are various considerations and concerns being considered in relation to how the reforms may impact the activities of stockbrokers. For example, Treasury is aware that a typical charging model for stockbrokers may involve a payment, commonly referred to as a 'commission', from the client to the broker that is typically charged as a percentage of the value of a certain transaction or a fee per transaction. These arrangements are being

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40 The Hon. Bill Shorten, MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms – Draft Legislation', *Media Release* 127, 29 August 2011.

41 Mr Doug Clark, Policy Executive, Stockbrokers Association of Australia, *Committee Hansard*, 23 January 2012, p. 51.

42 Mr Doug Clark, Policy Executive, Stockbrokers Association of Australia, *Committee Hansard*, 23 January 2012, p. 52.

43 ANZ Wealth, *Supplementary Submission 29*, p. 8.

44 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p. 65.

explored, however it is not the intent that a transparent and product neutral regime with a client-paid fee would be subject to the ban, unless it is an asset-based fee relating to geared products or investments amounts.

Treasury also understands that brokers do not always divide their fees into an advice component and a transaction brokerage component and is exploring the implications of this in relation to the reforms. The nature of payments between market-linked brokers and 'white label-brokers', as well as any payments between structured product providers and brokers are also being considered.

Treasury is undertaking further targeted consultation with industry on what types of payments will be permissible, while having regard to the principles the Government has announced in its reform package. Legislation will have the capacity to carve out specified payments if unintended payments are captured, or unintended consequences occur.[45]

The timeshare industry

7.43 The timeshare industry provides vacations to members through a managed investment scheme structure. Members can earn Vacation credits which are deemed financial products under the *Corporations Act*.[46] The Australian Timeshare and Holiday Ownership Council (ATHOC) expressed concern that their business models have been unintentionally caught in the regulatory design of the proposed FOFA reforms.[47]

7.44 Several members of the timeshare industry have argued that the reforms will remove the possibility for timeshare issuers to remunerate sales representatives and will either jeopardise the industry[48] or make it unviable.[49] Gold Coast Tourism argues that if the timeshare industry is not exempted from the Bill 'there could be substantial and material negative impact on the timeshare industry and tourism in Australia'.[50]

7.45 Timeshare industry participants have supported a carve-out on the basis that a timeshare product differs from other financial products. Classic Holidays highlighted some of the key differences:

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45 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'How will the ban on conflicted remuneration structures affect stockbrokers?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

46 Wyndham Vacation Resorts Asia Pacific Pty Ltd, *Submission 46*, p. 3.

47 Australian Timeshare and Holiday Ownership Council, *Submission 45*.

48 Accord Vacation Club, *Submission 54*, p. 4.

49 Classic Holidays, *Submission 36*, p. 1; Australian Timeshare and Holiday Ownership Council, *Submission 45*, p. 5; The Holiday Club, *Submission 47*, p. 1; Accommodation Association of Australia, *Submission 63*, p. 1.

50 Gold Coast Tourism Corporation Ltd, *Submission 35*, p. 1; Queensland Tourism Industry Council, *Submission 56*, p. 2.

- timeshare only sells a single product and there is little likelihood for conflict or consumer confusion and resultant consumer harm;
- holiday interests are not distributed through dealer groups or advisors, but are sold directly through sales offices, therefore volume-based payments have no wider impact on competition in the financial planning industry; and
- holiday interests are an in-house product and not provided by a financial product manufacturer.[51]

7.46 Further, ATHOC emphasised that timeshare is a lifestyle product and not a personal financial investment, and this is made clear to consumers before purchase:

> Timeshare is not sold or offered as a financial investment, it is not designed or sold to improve a consumer's financial wellbeing any more than the purchase of a car or other discretionary purchases and is not designed or represented to hold its value upon resale. Sales staff do not provide advice to customers or potential customers about different ways of investing their money, only advice as it relates to purchasing this holiday product. Our product, timeshare, just happens to be regulated as a financial product under the Corporations Act. Indeed, in most jurisdictions timeshare is regulated as a real estate, not as a financial product.[52]
>
> In all of our disclosure documents and compliance plans it quite clearly states that this is not an financial investment. We have this in an owner understanding that we go through with a consumer that decides to buy before they purchase to make sure that they fully understand that there is no financial gain, that the product will not increase in value, and that this is not a financial investment, that it is an investment in their lifestyle.[53]

7.47 ATHOC argued that the 'best interests' duty proposed in the Bill would prevent a timeshare representative advising a consumer to purchase a larger amount of time share than would be in the client's best interest.[54] Moreover, ATHOC emphasised that timeshare representatives adhere to a specific set of regulations and disclosure requirements designed to protect consumers:

> The industry and even some of the legislative bodies have openly said that we are very highly regulated. All through the process there are consumer protection measures, even going to the last aspect. If someone buys, they have a seven-day cooling off period. But before they get to that stage, when they say, 'We would like to buy this product and we have understood what has been said here today,' we have a one-page owner understanding form that goes through and highlights specific points that we are governed by.

51 Classic Holidays, *Submission 36*, p. 1.

52 Mr Barry Robinson, CEO, Australian Timeshare and Holiday Ownership Council Ltd, *Committee Hansard*, 24 January 2012, p. 33.

53 Mr Barry Robinson, CEO, Australian Timeshare and Holiday Ownership Council Ltd, *Committee Hansard*, 24 January 2012, p. 34.

54 Australian Timeshare and Holiday Ownership Council Ltd, *Submission 45*, pp 3–4.

> One is that this is not a financial investment. They have to initial against that. The second part says, 'You are not going to get a return on this. This is a lifestyle investment. Please sign.' They get a cooling-off period statement that they have to acknowledge, and we keep a record that they have received it and they can send it back to us if they wish to renege on it within seven days.[55]

7.48 Finally, ATHOC argued in its submission that the rationale behind the basic banking product exemption for ADIs could also be applied to the timeshare product:

> Like ADIs, timeshare companies generally arrange their sales teams by means of a sales office such that consumers appreciate that the representatives they purchase their timeshare from are employed by the timeshare company and their job is to sell the product. In our opinion, the situation is exactly analogous to that of the ADI employee.[56]

Committee view

7.49 The committee recognises the intent of the FOFA reforms was not to capture the Timeshare industry given it is not offering a financial services product. Therefore, the committee recommends that the Timeshare industry is carved out from the bans on conflicted remuneration.

Recommendation 13

7.50 The committee recommends that the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended so that the Timeshare industry is precluded from the bans on conflicted remuneration.

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55 Mr Barry Robinson, CEO, Australian Timeshare and Holiday Ownership Council Ltd, *Committee Hansard*, 24 January 2012, p. 37.

56 Australian Timeshare and Holiday Ownership Council Ltd, *Submission 45*, p. 4.

Chapter 8

Discretionary powers of the Australian Securities and Investments Commission

8.1 The Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) enhances the Australian Securities and Investments Commission's (ASIC's) licensing and banning powers. Currently, ASIC only has the ability to prosecute licensees: the Bill will allow ASIC to prosecute individual financial advisers in breach of their obligations.

8.2 Under the new provisions, ASIC's licensing and banning powers will be extended to:

- refuse or cancel/suspend a licence where ASIC has a reason to believe a person is likely to contravene (rather than will breach) its obligations;
- ban a person (as opposed to an entity) who is not of good fame and character or not adequately trained or competent to provide financial services;
- consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions;
- ban a person if it believes they are likely to (rather than will) contravene a financial services law; and
- ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.[1]

8.3 These provisions are in response to concerns raised by ASIC about its ability to protect investors by restricting or removing industry participants who may cause investor losses. ASIC has encountered difficulty in this process because the licence threshold entry is low and the threshold for cancelling a licence is relatively high.[2]

8.4 Treasury noted the difficulties that ASIC has in taking a proactive approach to protect consumers and that the Bill is intended to address this issue:

> It is recognised that while there are important reasons for the current formulation of ASIC's powers (around, for example, natural justice for licensees and their representatives), current evidentiary thresholds make it very difficult for a regulator to be proactive in protecting consumers before an adverse outcome takes place. Under current arrangements, it is relatively

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1 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 20.

2 Australian Securities and Investments Commission, *Submission 28*, p. 6.

easier to be reactive by enforcing the law after it has been breached and after potential adverse outcomes have already taken place.

In light of the above concerns, in the Ripoll Report recommended that the Corporations Act should be amended to provide extended powers for ASIC to ban people from the financial services industry under section 920A (recommendation 6). It also recommended that ASIC be able to deny a licence application or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with its obligations under sections 913B and 915C of the Corporations Act (recommendation 8).15

As a result of this recommendation, the Bill clarifies the operation of ASIC's banning power and sets out new tests under which ASIC can exercise its discretion to remove persons from the financial services industry.[3]

Adequacy of ASIC's current powers

8.5 Currently, ASIC can suspend or cancel a license or ban an individual after a hearing when a licensee has failed to meet their obligations, or if ASIC has reason to believe that a licensee will not comply with their obligations in the future. Following a hearing, ASIC can also suspend or cancel a licence when it is no longer satisfied that the licensee is of good fame or character, a banning order is made against the licensee or a key representative of the licensee, or the application was materially false or misleading or omitted a material matter.[4]

8.6 ASIC's position is that the current laws make it difficult to cancel a licence or refuse to grant one. ASIC can only immediately suspend or cancel a license of an entity in limited circumstances; for example, if a licensee has committed serious fraud, is insolvent, ceases to carry on the business, or is incapacitated.[5]

8.7 Further, ASIC argues that it has struggled to prove its case when its decisions have been appealed before the Administrative Appeals Tribunal (AAT) and that this 'makes it difficult to remove licensees who may potentially cause investor losses in advance of an actual breach':[6]

> If we were to express it in general terms, we would say that the challenge that ASIC faces is that the barriers to entry to this industry are, frankly, too low in terms of ASIC's ability to keep out players that we believe are going to create problems, and it is too difficult for us to take out planners who are causing significant problems—the 'bad apples' that the industry is concerned about. To give you a sense of ASIC's test of this issue of whether a person will or will not comply with the relevant law, the AAT has

3 Treasury, *Submission 22*, p. 8.

4 Australian Securities and Investments Commission, *Submission 28*, pp 7, 8–9.

5 Australian Securities and Investments Commission, *Submission 28*, p. 7.

6 Australian Securities and Investments Commission, *Submission 28*, p. 7.

> rejected ASIC's finding that a person will not comply with the relevant law in 10 matters. There have been only two matters where the AAT has accepted ASIC's finding that a person will not comply with the relevant law. So this is not something where we are speaking about a hypothetical.[7]

8.8 In addition, the licensing regime focuses on entities rather than its agents, such as employees or directors. This prohibits ASIC from refusing, restricting or banning an individual from providing financial services.[8] On the whole, ASIC relies on licensees to ensure the competency and integrity of its representatives in the industry.[9] Treasury noted broad concerns about 'the effectiveness of licensees being responsible for the actions of their representatives, with implications for the professionalism of the industry'.[10]

8.9 Moreover, ASIC is concerned that the current licensing regime does not align with general consumer expectations that there are assurances that a licensee will provide a high quality of financial services:

> The relatively low threshold for obtaining an AFS licence and the relatively high threshold for removing a licence is not well understood by retail investors. Licensing, therefore, may give retail investors a sense of security which is inconsistent with the settings of the regime. There is a perception amongst some consumers that an AFS licence means that the licensee has been approved by ASIC or that it signifies the high quality of the financial services provided by the licensee, which is not the case.[11]

Submitters' views

8.10 Broadly speaking, the majority of submitters to the inquiry supported the new discretionary powers granted to ASIC to prosecute individuals,[12] provided there is clarity regarding the circumstances under which the powers can be employed, and there are controls in place around the application of the powers.[13] The Australian Institute of Superannuation Trustees (AIST) stated:

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7 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 January 2012, pp 72–73.

8 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p.18; Australian Securities and Investments Commission, *Submission 28*, pp 3–4.

9 Australian Securities and Investments Commission, *Submission 28*, p. 8.

10 Treasury, *Submission 22*, pp 7-8.

11 Australian Securities and Investments Commission, *Submission 28*, p. 9.

12 Chartered Secretaries Australia Ltd, *Submission 13*, p. 4; Abacus – Australian Mutuals, *Submission 14*, p. 1; Trustee Corporations Association of Australia, *Submission 16*, p. 2; Boutique Financial Planning Principals Group, *Submission 48*, p. 6.

13 Association of Financial Advisers, *Submission 67*, p. 5; Industry Super Network, *Submission 12*, p. 5; Financial Services Council, *Submission 58*, p. 21; Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, Joint Accounting Bodies, *Committee Hansard*, 24 January 2012, p. 54.

> Overall, AIST is supportive of the enhanced licensing and banning powers that are proposed to be given to ASIC. ASIC has raised concerns about its ability to protect investors and we feel that the changes slated to improve the supervision of the financial services industry are critical to creating greater trust within the Australian community toward the sector and moving the financial planning industry further toward a profession.[14]

8.11 A number of submitters, however, argued that the new powers are too broad and called for further clarity on how certain provisions will be applied and interpreted. The Joint Accounting Bodies (JAB), for example, commented:

> 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.[15]

Review process for ASIC decisions

8.12 The Australasian Securities Dealers Association Inc. voiced concern that without adequate controls in place, ASIC's powers could be used maliciously:

> Whilst we understand that the Government may feel the need to give ASIC such sweeping powers, we are concerned that appropriate check and balances are not in place to prevent malicious pursuit of advisers or licensees under their supervision. Most enforcement agencies throughout the developed world have an internal agency or overseeing body that has the ability to conduct investigations.
>
> Banning orders, enforceable undertaking and disqualifications are handed out by ASIC and in most cases with good reason. We do however see that if such a malicious pursuit did occur under 920(1A)(d) then the tarnished image of the adviser or AFSL would be significant.[16]

8.13 The Financial Services Council called for assurances that ASIC's enhanced powers will be used only if a hearing for licensees and individuals has occurred:

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14 Australian Institute of Superannuation Trustees, *Submission 18*, p. 4.

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

16 Australasian Securities Dealers Association Inc, *Submission 10*, pp 3–4.

> 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.[17]

8.14 The Explanatory Memorandum (EM) does indeed outline that 'existing review rights in relation to ASIC decisions about licensing and banning continue to apply' (including those under the provisions of the Bill) and, as such, are subject to review by the Administrative Appeals Tribunal.[18]

8.15 As a matter of general principle, ASIC must give persons affected by its decisions an opportunity to be heard (either in writing or orally). The Corporations Act and Regulations specifically give a person a statutory right to a hearing in certain circumstances. This includes instances where a decision is made to refuse, vary or revoke a license:[19]

> Under s913A of the Corporations Act a person may apply to ASIC for an Australian financial services licence. ASIC must, before refusing to grant a licence, give the affected person an opportunity to have a private hearing.
>
> Under s914A(1) of the Corporations Act ASIC may impose conditions on a financial services licence. If ASIC imposes conditions when the initial licence application is granted the affected person has no statutory right to a hearing (see s914A(3)). If, however, after granting the initial licence, ASIC proposes to vary, revoke or impose additional conditions the affected person does have a statutory right to be heard at a private hearing.[20]

Further clarity required: 'Reason to believe' and 'likely to contravene'

8.16 A number of submitters claimed that certain provisions of the Bill carry significant uncertainty for financial advisers, particularly the provision allowing ASIC to ban or refuse a license on the grounds that a person is 'likely to contravene' obligations under the Act.[21]

8.17 The Financial Planning Association of Australia (FPA), for example, expressed concern that the phrases 'reason to believe' and 'is likely to contravene' are too flexible and allow ASIC to take action prior to a breach being committed, with

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17 Financial Services Council, *Submission 58*, p. 21.

18 Explanatory Memorandum, p. 22.

19 Australian Securities and Investments Commission, *Regulatory Guide 8: Hearings practice manual*, March 2002, pp 3, 4.

20 Australian Securities and Investments Commission, *Regulatory Guide 8: Hearings practice manual*, March 2002, p. 24.

21 Stockbrokers Association of Australia, *Submission 8*, p. 10; Joint Accounting Bodies, *Submission 23*, p. 2; National Insurance Brokers Association of Australia, *Submission 59*, p. 8.

minimal obligation on the Commission. The Superannuation Committee of 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.[22]

Requests for a legislated statutory test

8.18 The FPA recommended that the EM and/or the Regulations should detail an objective test that ASIC would have to meet to show reason to believe that an applicant, licensee or provider is 'likely to contravene' its obligations. The FPA suggested that ASIC should have a range of appropriate actions it can take if it has reason to believe a licensee, representative, applicant or provider is 'likely to contravene' its obligations, such as further investigations, an Enforceable Undertaking or education requirement.[23]

8.19 The Australian Bankers' Association (ABA) was also concerned about the breadth of ASIC's new discretionary powers and application of penalties, particularly in the absence of a reasonable steps defence. ABA agreed that there is a need for regulations to address these concerns.[24] The Joint Accounting Bodies agreed with this view, and recommended that ASIC issue a statement which sets out how they intend to use the proposed powers, particularly in relation to the terms 'believe' and 'likely to contravene':

> These are broad terms and therefore have the capacity for misuse. While we believe that ASIC has no intention to misuse such powers, in order to generate confidence in the new system ASIC must set out how it will interpret the law and how it will implement them.[25]

8.20 The Westpac Group also called for objective criteria that ASIC would be required to follow when exercising its new discretionary powers. The Westpac Group suggested the criteria could include items such as:

- the number of previous similar contraventions the individual/licensee holds;

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

23 Financial Planning Association of Australia, *Submission 62*, p. 15.

24 Australian Bankers' Association, *Submission 67*, p. 40.

25 Joint Accounting Bodies, *Submission 23*, pp 4-5; see also Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants, Joint Accounting Bodies, *Committee Hansard*, 24 January 2012, p. 54.

- the likelihood of a contravention remaining unrectified; and
- the extent to which the likely contravention indicates the licensee or individual will not comply with their obligations in general.[26]

8.21 At this stage, Treasury has not released a statutory test or any specific criteria ASIC would follow that would equate to ASIC having reason to believe that a person is 'likely to contravene' a financial services law. However, there is some further clarification provided in the EM which outlines the due diligence and evidentiary processes proposed for ASIC:

> The statutory test is whether the applicant is likely to contravene the obligations under section 912A. ASIC may take into account any information relevant to this question, such as:
>
> - conduct of the applicant that shows deliberation and planning in wilfully disregarding the law;
> - the extent of compliance by the applicant with analogous obligations in another regime; or
> - any other conduct of the applicant that may lead ASIC to conclude, on reasonable grounds, that the applicant is not likely to comply.[27]

8.22 The EM highlights that the current legislative standards are too onerous for ASIC to prove that a person is 'likely to contravene' a financial services law, and the new provisions allow ASIC to act appropriately in these circumstances:

> In the 10 years since the introduction of the Financial Services Reform Act, interpretation of this provision has tended to a view that ASIC is required to believe, as a matter of certainty, that the person will contravene the obligations in future. Such a standard would be so onerous that it could result, in practice, in ASIC never being able to refuse a licence using this part of the test. This new formulation is designed to ensure that ASIC can more appropriately account for the likelihood or probability of a future contravention.

8.23 The committee acknowledges the concerns of submitters and notes that ASIC has undertaken to provide further regulatory guidance on its amended licensing and banning powers.[28] In addition, it suggests that the committee has itself an important role to monitor the way in which ASIC uses these new powers.

8.24 The committee notes that as part of its ongoing oversight of ASIC, it will closely monitor the exercise of ASIC's new licensing and banning powers as conferred through the Future of Financial Advice legislation.

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26 The Westpac Group, *Submission 64*, p. 11.

27 Explanatory Memorandum, pp 22-23.

28 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 3; Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Committee Hansard*, 24 January 2012, p. 73.

Chapter 9

The projected impact of the FOFA reforms on the financial advice industry

9.1 This chapter examines the projected impact of the Future of Financial Advice (FOFA) legislation on the financial advice industry. The best available evidence suggests that, notwithstanding the difficulty of making precise estimates of the employment impact, there is likely to be a short-term increase in the number of financial advisers, before returning to levels broadly similar to current employment numbers.

9.2 The FOFA reforms will significantly increase the number of advisers giving scaled advice. While the total number of financial advisers will continue to consolidate under the FOFA reforms, the sharp increase in the provision of scaled advice will lead to 1.77 million pieces of financial advice being provided by 2025–26. This is double the estimated pieces of advice if the FOFA reforms were not to proceed.[1] Moreover, the committee emphasises that clients will have greater confidence in the quality of this advice under the FOFA reforms.

The projected impact on industry

9.3 The issue of the potential impact of the FOFA reforms on the financial advice industry in Australia has attracted comment in the media and in professional forums.[2] The committee's deliberations on the issue centred on three main aspects:

- the impact on employment and the current structure of the financial advice sector;
- the cost to advisers of the 'opt-in' requirement (see chapter 3); and
- the adequacy of Treasury's Regulatory Impact Statements (RIS).

The impact on employment

9.4 The Explanatory Memorandum (EM) notes that while there is likely to be a consolidation of the financial advice industry with larger institutionally owned dealer

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1 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 3.

2 See 7.30 Report, 'Financial planners fight for industry reform', ABC Television, 15 February 2012, http://www.abc.net.au/7.30/content/2012/s3431811.htm (accessed 20 February 2012). ASIC Summer School: 'Building resilience in turbulent times', 'Good advice: the impact of FOFA', 20 February 2012. http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-SS12-Program-16-Feb-2012.pdf/$file/ASIC-SS12-Program-16-Feb-2012.pdf (accessed 20 February 2012).

groups (licensees) acquiring a number of smaller dealer groups, the extent of job losses is unknown.[3] A footnote in the EM cited research from Rice Warner Actuaries suggesting that adviser numbers will reduce from around 15,400 advisers in 2010 to around 8,600 in 2024.[4] This estimated decrease in adviser numbers of 6,800 was cited during the committee's public hearings.[5]

9.5 The committee questions the 6,800 job loss figure. It noted that the research on which the figure is based is from Rice Warner's March 2010 report. As the actuarial firm recognises, this report used assumptions about the FOFA package that are now irrelevant. In particular, the 2010 report assumed a ban on commissions for retail risk insurance and a ban on asset based fees. The current bill does not include these bans. Indeed, in its evidence to the committee, Treasury noted that 'the risk of possible reductions in insurance advice is one of the main reasons why the government decided not to ban all insurance commissions'.[6]

9.6 These changes were factored into a January 2012 Rice Warner report on the financial advice industry under the FOFA reforms. Whereas the March 2010 report estimated a 23 per cent decrease in adviser numbers over the 14 years following the regulatory change:

> [T]he January 2012 report estimates that the number will be broadly stable with the final outcome subject to commercial strategies in response to the reforms...We note, in particular, that risk insurance currently generates around 40% of adviser revenue.[7]

9.7 The 2012 Rice Warner report concluded that under the FOFA reforms, there is likely to be a short-term boost to total adviser employment before 'setting toward a total level of employment broadly similar to the levels existing today'.[8] Total adviser employment is estimated to be 17,711 at 30 June 2012 and 17,068 at 30 June 2022 (see Table 9.1).

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3 Explanatory Memorandum, p. 43.

4 Explanatory Memorandum, p. 44.

5 See, for example, Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, pp 12, 14.

6 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 59.

7 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 8.

8 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 5.

Table 9.1: Change in number of advisers, 2011–2026

30 June	Total number of advisers **before** regulatory change (full advisers and scaled)	Total number of advisers **after** regulatory change (full advisers and scaled)	Difference before and after (in a given year)	Change (from base year 2012)
2011	17,600	17,600	0	
2012	17,711	17,711	0	
2013	17,816	21,489	3,673	3,778
2014	17,934	21,779	3,845	4,068
2015	18,052	21,328	3,276	3,617
2016	18,180	19,966	1,786	2,255
2017	18,313	18,697	384	986
2018	18,443	17,617	-826	-94
2019	18,573	17,303	-1,270	-408
2020	18,649	17,227	-1,422	-484
2021	18,711	17,150	-1,561	-561
2022	18,776	17,068	-1,708	-643
2023	18,846	16,990	-1,856	-721
2024	18,913	16,907	-2,006	-804
2025	18,982	16,827	-2,155	-884
2026	19,041	16,740	-2,301	-971

Source: Table adapted from Tables 12 and 13 of 'The Financial Advice Industry Post-FOFA', Rice Warner Actuaries, January 2012, pp. 38–39.

Table 9.2: Change in number of advisers giving full & scaled advice 2011–2026

30 June	Number of Advisers giving full financial advice before regulatory change	Number of advisers giving full financial advice after regulatory change	Change in number of advisers giving full advice	Number of advisers giving only scaled financial advice before regulatory change	Number of advisers giving only scaled financial advice after regulatory change	Change in number of advisers giving scaled advice
2011	17,300	17,300	0	300	300	-
2012	17,407	17,407	0	304	304	-
2013	17,508	20,929	3,421	308	560	252
2014	17,621	21,087	3,466	313	692	379
2015	17,734	20,500	2,766	318	828	510
2016	17,857	19,000	1,143	323	966	643
2017	17,985	17,590	-395	328	1,107	779
2018	18,110	16,367	-1,743	333	1,250	917
2019	18,235	15,908	-2327	338	1,395	1,057
2020	18,306	15,684	-2,622	343	1,543	1,200
2021	18,363	15,457	-2,906	348	1,693	1,345
2022	18,422	15,223	-3,199	354	1,845	1,491
2023	18,486	14,991	-3,495	360	1,999	1,639
2024	18,548	14,753	-3,795	365	2,154	1,789
2025	18,612	14,515	-4,097	370	2,312	1,942
2026	18,666	14,269	-4397	375	2,471	2,096

Source: Table adapted from Tables 12 and 13 of 'The Financial Advice Industry Post-FOFA', Rice Warner Actuaries, January 2012, pp. 38–39.

9.8 Rice Warner explained that the short-term increase in adviser numbers may occur as a result of the shift to a fee-for-advice model, away from trail commissions and asset based fees. The 2012 report emphasised that underlying the FOFA reforms will be the 'key drivers' of an ageing population and maturing superannuation system which will ensure there are 'significant opportunities for growth in the financial advice industry'.[9]

9.9 Rice Warner's finding of the short-term increase in adviser numbers under the FOFA reforms is corroborated by other research. Treasury drew the committee's attention to IBIS forecasts that the average annual number of advisers will grow by 2 per cent up to 2015. Treasury noted '[W]e would see the industry adapting to these proposals and there not being significant job losses'.[10]

9.10 Table 9.1 also shows that for each year from 2012–2017, the number of advisers will be higher under the FOFA reforms than if the reforms are not implemented. In 2014, for example, the Rice Warner analysis indicates there will be 21,779 financial advisers compared with only 17,934 in 2014 should the FOFA reforms not go ahead.[11]

9.11 In each year from 2018–2026, however, the total number of financial advisers will fall under the FOFA reforms. For each of these years, the number of advisers assuming no FOFA reforms will increase on the previous year; the number of advisers assuming FOFA is implemented will decrease on the previous year (see Table 9.1).

9.12 Table 9.2 provides a breakdown of the data from Table 9.1. It shows that while the number of advisers giving full financial advice will fall from 2018–2026 as a result of the FOFA reforms, the number of advisers giving only scaled advice will increase for each year from 2013–2026 under the reforms. Indeed, taking 2012 as a base year, the increase in the number of advisers giving scaled advice under the FOFA reforms will more than triple by 2016 (966) and increase eight-fold by 2026 (2,471).

Wild estimates

9.13 The committee received varying evidence on the extent to which the legislation would affect the financial advice industry. The committee believes that the considerable discrepancy in these estimates of job losses raises questions as to the reliability of estimates at the higher end.

9.14 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

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9 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 4.

10 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 59.

11 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, pp 38–39.

few years.[12] Mr Richard Klipin, Chief Executive Officer of the Association of Financial Advisers, told the committee that FOFA will 'decimate' the financial advice profession with over 6,800 adviser jobs at risk and over 30,000 jobs in total. *The Australian* newspaper reported Mr Klipin's comment that 'losses over coming years could reach 35,000 once the cuts flowed through to back-office personnel'.[13]

9.15 In evidence to the committee, Mr Jim Murphy, Executive Director of the Markets Group in Treasury, commented on the issue of job losses from the FOFA reforms. Of the 35,000 job loss estimate, he told the committee:

> I just think that is silly. It seems to me that there is going to be increased use of financial services. There is going to be increased wealth and money going into the financial services sector; I cannot see how there could be job losses. There may be job losses where people who have not been engaged in the industry, or who have relied on the basis of commissions, will have to change major practices and are towards the end of their career. But anyone who is a financial planner who has been engaged, I would expect, would be able to quite easily adopt a change in practices.[14]

Committee view

9.16 The committee makes the point that previous reforms to the financial services sector, such as the Financial Services Reform Act (FSRA), were also met with initial apprehension. In the case of the FSRA reforms, they have been well received and the committee believes that once implemented and bedded down, the FOFA reforms will also be seen as very positive.

Recommendation 14

9.17 The committee recommends that the government should amend the footnote references to Rice Warner estimates in the regulation impact statements of the Explanatory Memorandums to both bills. The new footnote should be updated to reflect Rice Warner's revised estimate of the employment impact of the Future of Financial Advice reforms.

The impact on the structure of the financial advice industry

9.18 The committee received some evidence on the potential impact of the FOFA reforms on the structure of the financial advice industry. In particular, there was comment that large financial advisory firms employing many advisers across a range of financial services will face less competition from firms with relatively few advisers.

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12 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 3.

13 Andrew Main, '35,000 jobs at risk as advice reforms bite', *The Australian*, 24 January 2012, p. 17.

14 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Committee Hansard*, 24 January 2012, p. 58.

9.19 The Association of Financial Advisers, for example, argued that the FOFA reforms will lead to further consolidation of the financial advice industry, resulting in more concentration and less competition.[15] AMP Financial Services was asked its view of the competitive neutrality of the FOFA legislation. The Managing Director, Mr Meller, responded that with the prospect of lower cost bases and transitional investments:

> ...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.[16]

9.20 Mr Grahame Evans, Group Managing Director of Professional Investment Services, gave the committee examples of where the industry had already consolidated and the impact of these events. He noted the case of Count Financial, a Sydney-based advisory firm with 60 staff:

> 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?[17]

9.21 Mr Evans argued that the FOFA reforms, in their effort to protect consumers, threatened to reduce competition in the industry and choice for consumers. As he told the committee:

> 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.[18]

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15 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers Ltd, *Committee Hansard*, 23 January 2012, p. 18.

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

17 Mr Grahame Evans, Group General Manager, Professional Investment Services, *Committee Hansard*, 23 January 2012, p. 74.

18 Mr Grahame Evans, Group General Manager, Professional Investment Services, *Committee Hansard*, 23 January 2012, p. 74.

9.22 Associate Professor Joanna Bird told the committee that the consolidation of the financial advice sector was already happening. She noted that while it is difficult to foresee the exact impact of the FOFA reforms on the sector:

> My instinct is that there would be some initial consolidation but eventually a truly independent and professional financial advice industry would emerge. These reforms are an important part of that evolution towards a truly professional financial advice industry.[19]

Committee view

9.23 The committee believes that as with any major reform, there will be adjustments and transitions. It argues that while competition among financial advisory services is important, the quality of advice and the professionalism of the industry are paramount. The FOFA reforms will create a highly professional financial advice industry. Further, as systems are developed and refined to meet the annual disclosure and 'opt-in' obligations, the large financial advisory firms will face more competition from small and medium sized entrants.

The impact on advice

9.24 The January 2012 Rice Warner report estimates that the FOFA reforms 'are likely to lead to an increase in the total number of pieces of financial advice'. By 2025–26, it estimates there will be 1.77 million pieces of advice provided compared with 831,000 pieces in the same year if the FOFA reforms were not to proceed. As noted above, Rice Warner explains this increase principally in terms of the growth of scaled advice. It estimates there will be 1 million pieces of scaled advice by 2025–26 compared to only 170,000 in 2025–26 if the reforms are not made.[20]

The cost of opt-in

9.25 The EM notes that 'advisers will also incur ongoing annual costs in that they must have clients opt-in each year to continue to provide ongoing service'.[21] Chapter 3 noted Rice Warner's estimate that the cost of 'opt-in' will be about $22 million per annum and, on the basis of 2 million Australians receiving financial advice, a cost per client of $11 per year.[22] Of this estimate, Rice Warner explained that the:

> ...estimated cost of ‘opt-in’ assumes that the adviser is already in regular contact with their clients, meeting at least once every year. We consider this a reasonable assumption given the oft stated position that advisers are

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19 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 62.

20 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 3.

21 Explanatory Memorandum, p. 61.

22 See chapter 3. Rice Warner's submission to the government citing figures is available at: http://www.ricewarner.com/images/newsroom/1316044106_The%20Cost%20of%20Opt-in_Government%20Submission.pdf (accessed 14 February 2012).

> providing ongoing service and advice. Hence, the discussion and request regarding renewal of the advice services can take place as part of that normal adviser / client interaction. This may not be the case for some existing business. However, the proposed grandfathering provisions will mean that 'opt-in' will only apply for new clients from 1st July 2012, so the first 'opt-in' will occur on 1st July 2014. Thus, advisers who adapt their business models to include annual (or at least biennial) client reviews for all new clients will be able to incorporate the 'opt-in' process into their normal client management processes.
>
> Consequently, our estimate of the cost of 'opt-in' assumes no additional time and work required to meet with or talk to clients since we regard this as part of a normal advice service. Whilst we have no knowledge of the basis of other 'opt-in' cost estimates, we suspect that these treat such client contact costs as stand alone costs separate from the costs of the normal regular contact. In fact, one to two hours of an adviser's time in a client interview could, alone, have a time cost of $200 or more. However, we believe that it is unlikely that advisers will be conducting extra, separate meetings merely to gain their clients' approval to 'opt-in'.[23]

9.26 The committee agrees with these assumptions. It does note, however, that some witnesses queried the assumptions underpinning the Rice Warner estimate. AMP Financial Services, for example, told the committee that the 'retrospective nature and the requirement to bring all the mature products into the reporting framework' was probably not in the Rice Warner estimate. Further, these costs would add considerably to both the ongoing and implementation costs of the opt-in requirement.[24]

9.27 As noted in Chapter 3, the projected cost of opt-in per client varies significantly depending on assumptions of what will be required from advisers. The Financial Planning Association's estimate, based on an independent survey of advisers, was $132 per client;[25] Burrell Stockbroking and Superannuation's estimate was five times this amount at 'around $650' per client.[26]

9.28 Apart from the considerable discrepancies in these estimates, the committee also observes that there has been some vagueness as to what is being estimated. The Financial Services Council, in both its written submission and in its verbal evidence to the committee, appeared to confuse the cost of opt-in with the cost of annual disclosure. Its submission produced a table from a November 2011 survey which

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23 Rice Warner, 'The Cost of Opt-in', *Submission to the government*, 15 September 2011, p. 4 http://www.ricewarner.com/images/newsroom/1316044106_The%20Cost%20of%20Opt-in_Government%20Submission.pdf (accessed 14 February 2012).

24 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 8.

25 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 42.

26 Burrell Stockbroking and Superannuation, *Submission 11*, p. 2.

listed the average cost per client of summary ($54) and detailed ($98) fee disclosure statements.[27] In evidence to the committee, however, these costs were identified as the cost of opt-in.[28]

9.29 Moreover, the committee draws attention to the comments of AMP and the Financial Planning Association, which are important qualifiers to the financial advice industry's estimates of the impact of 'opt-in':

> The reality is that no independent impact statement has been done on the cost of this to either participants or consumers, and that is the heart of the matter for this issue.[29]
>
> ...you will not actually know what the real cost is until you do this full regulatory impact statement so that you can get down and get some detailed estimates as to what it does cost on an annual opt-in basis.[30]

The Regulatory Impact Statement

9.30 The EM to the bill contains a Regulatory Impact Statement (RIS). The EM acknowledges at the outset that the RIS is based on the policies announced by the government in April 2010.

9.31 On 8 August 2011, the Office of Best Practice Regulation (OBPR) noted that an adequate RIS was prepared on the 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. The OBPR thereby assessed the proposals as being 'non-compliant' with the Australian Government's best practice regulation requirements.[31]

9.32 The OBPR elaborated on these issues in evidence to the Senate Finance and Public Administration Legislation Committee in February 2012. Mr Jason McNamara, the Executive Director of the OBPR, explained that:

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27 Financial Services Council, *Submission 58*, p. 7.

28 Ms C. Storniolo, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 37.

29 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 42.

30 Mr Alastair Kinloch, Director, Government Affairs, *Committee Hansard*, 23 January 2012, p. 8.

31 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).

> Treasury provided a number of RISs...I think that there were six separate RISs...But we found those RISs not yet adequate. They had not met the best practice requirements.
>
> 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.[32]

9.33 In terms of the reason for the inadequacy of these RISs, Mr McNamara recognised that the lack of time was a key factor:

> The timing was an aspect in terms of getting the RIS to an adequate standard. Essentially, as Treasury were preparing RISs, we had exchanged drafts, so it was an ongoing process and it is true that time ran out...
>
> The issue was that the regulatory impact statement has to be prepared before a decision is made. So, once the decision is made there really is not a need for regulation impact statements. So, it is to inform the decision-making stage. Departments can voluntarily choose to do one for attachment to an explanatory memorandum but, in general, our system requires it to be done before the decision.[33]

9.34 In evidence to the committee during this inquiry, Treasury also acknowledged that time was a key factor in the OBPR's finding that RISs were inadequate. Mr Jim Murphy, Head of Markets Group at the Treasury, explained:

> The government made it very clear that it wanted to introduce these bills, and the OPBR took the position that they could not approve them in the time. That is how we ended up with this result. What I am saying to you is that two things have emerged: firstly, there is a review of the way risk processes operate—I think there are some issues about the way they operate, but that is just my personal opinion; and, secondly, I cannot speak for the minister but it would clarify these matters if these regulatory impact statements could be released in some way.[34]

9.35 Indeed, Mr Murphy told the committee that it would be 'very helpful' if the six regulatory impact statements were released and added, 'I am hoping to take that up with the minister'.[35]

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

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

34 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury *Committee Hansard*, 24 January 2012, p. 60.

35 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury *Committee Hansard*, 24 January 2012, p. 60.

9.36 Certainly, the absence of Regulatory Impact Statements was the target of criticism from some witnesses. AMP Wealth Management 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.[36]

9.37 Some witnesses, such as the Financial Services Council, supported a full regulatory impact statement on the condition that the implementation date is moved back. Others witnesses prioritised implementing the legislation.[37] Ms Pauline Vamos, Chief Executive Officer of the Association of Superannuation Funds of Australia, was asked her view on whether the government should conduct a full RIS before proceeding with the legislation. She responded:

> We certainly believe it is best practice. In terms of this particular legislation, we would not advocate going backwards. We believe that the public policy outcomes that are trying to be delivered are clear. There needs to be time to adjust; there needs to be time to implement. It is such a significant consumer reform that it is important that is proceeded with.[38]

9.38 The Australian Securities and Investments Commission (ASIC) told the committee that beyond RISs, an assessment can be made 'a year or two after the legislation has been introduced' to see how it is working in practice.[39] The committee strongly supports this review (see chapter 10, recommendation 15).

9.39 The committee also argues that the government should consider publicly releasing the six RISs that were not assessed by the OBPR as adequate. It notes that Treasury appears to support this approach.

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36 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 1.

37 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 35.

38 Ms Pauline Vamos, Chief Executive Officer, ASFA, *Committee Hansard*, 24 January 2012, p. 16.

39 Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, p. 68.

Committee view

9.40 The committee believes it should be up to the Minister to decide whether to publicly release a cost benefit analysis or the six Regulatory Impact Statements that were prepared by Treasury and assessed by the Office of Best Practice Regulation as not adequate for the decision-making stage. If the Minister does decide to release this information, the committee believes that this should be done prior to the legislation being enacted.

Chapter 10

The consultation process and implementation timeframe

10.1 The final chapter of this report details the extensive consultation process undertaken by the government on the Future of Financial Advice (FOFA) reforms. It then notes stakeholders' views on the implementation timeframe for the legislation.

The consultation process

10.2 On 26 April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, announced the FOFA reforms.[1] On 28 April 2011, the Assistant Treasurer and Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, announced further detail on the operation of the reforms.[2] In providing this detail, Minister Shorten noted:

> Since the Government announced the reforms there has been extensive consultation with stakeholders. The Government has carefully weighed and balanced all the feedback provided in consideration of today's announcement. I greatly appreciate the active engagement from industry in the preparation and early implementation of these reforms.[3]

10.3 The government released draft legislation and a draft Explanatory Memorandum for the first FOFA Bill on 29 August 2011, with Treasury inviting comments on the draft by 16 September 2011. It received 47 submissions.[4] On 28 September 2011, the government released draft legislation and a draft EM on the

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1 The Hon. Chris Bowen MP, 'Overhaul of financial advice', *Media release 36*, 26 April 2010. http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType=0 (accessed 21 February 2012).

2 The Hon. Bill Shorten MP, 'Future of financial advice prioritises consumers', *Media Release No. 64*, 28 April 2011 http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/064.htm&pageID=003&min=brs&Year&DocType (accessed 27 January 2012).

3 The Hon. Bill Shorten MP, 'Future of financial advice prioritises consumers', *Media Release No. 64*, 28 April 2011 http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/064.htm&pageID=003&min=brs&Year&DocType (accessed 27 January 2012).

4 Treasury, *Exposure draft—Corporations Amendment Future of Financial Advice Bill 2011*, http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/corporations_amend/default.htm (accessed 21 February 2012).

second FOFA Bill and invited submissions by 19 October 2011. Treasury received 48 submissions.[5]

10.4 The Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 were introduced into the House of Representatives on 13 October 2011.

Support for Treasury's role

10.5 In evidence to the committee, Treasury noted that the reforms 'have had a long gestation period' and have involved 'extensive consultation' with industry over the past two years.[6] Treasury also told the committee that these consultations had led to changes in the government's approach:

> During the consultations, the industry's ability to adapt to the change was taken account of in the government's final proposals. That is why you saw the change in the opt-in proposal from 12 months to two years. That was the government's response to issues raised about the impact on the industry.[7]

10.6 Several stakeholders praised Treasury's efforts in consulting with industry on the reforms. ANZ Wealth was asked whether it had had an opportunity to discuss with Treasury some of the implications of the reforms including changes to IT systems and training manuals. ANZ Wealth General Manager, Mr Paul Barrett, responded:

> We have had a number of opportunities to consult with Treasury. We have provided them with a fairly detailed breakdown of the impacts on our systems and the number of hours involved, et cetera. I would like to take this opportunity to thank Treasury because they have been incredibly accessible throughout the process and very consultative.[8]

10.7 Mr John Brogden, Chief Executive Officer of the Financial Services Council (FSC), told the committee that:

> ...Treasury have been faultless through this process and they have been extraordinarily consultative. We are very happy with the access to Treasury. We also say publicly that, despite their best efforts, this has been very

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5 Treasury, *Exposure draft—Corporations Amendment Further Future of Financial Advice Bill 2011*, http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/corporations_further/default.htm (accessed 21 February 2012).

6 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 58.

7 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 59.

8 Mr Paul Barrett, General Manager, Advice and Distribution, ANZ Wealth, *Committee Hansard*, 24 January 2012, p. 9.

> complex and it is an area they have not had expertise in. So there has been a very significant learning period, but access has been exceptional.[9]

10.8 The Industry Super Network (ISN) Chief Executive, Mr David Whiteley, told the committee that the reforms 'are moderate and reasonable and have been developed over a period of years following consultation with all sectors in the financial services industry'.[10] The ISN also noted that the Bill's annual fee disclosure requirement was 'very well canvassed' in Treasury's consultation meetings.[11]

10.9 The Financial Planning Association told the committee that it has been 'a strong contributor' throughout the development of the legislation and provided 'many hundreds of pages of consultation feedback'.[12] It noted that it had participated in numerous consultation meetings and discussions hosted by Treasury as well as individually with the Minister's office.[13]

Consultation on the annual fee disclosure requirement

10.10 Chapter 3 discussed the issue of annual fee disclosure statements to be sent to all clients by financial advisers. The committee received comment from some stakeholders that the government's consultation on this provision was inadequate.

10.11 Mr Richard Klipin, Chief Executive Officer of the Association of Financial Advisers (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.[14]

10.12 The Financial Planning Association criticised the 'retrospective' aspect of the disclosure fee obligation, claiming the consultation process had only discussed applying this requirement to new clients (as per the draft legislation). It claimed that

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9 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 35.

10 Mr David Whiteley, Chief Executive, Industry Super Network, *Committee Hansard*, 24 January 2012, p. 18.

11 Ms Robbie Campo, Manager, Strategy, Industry Super Network, *Committee Hansard*, 24 January 2012, p. 23.

12 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 41.

13 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 41.

14 Mr Richard Klipin, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 16.

this change had created confusion among stakeholders.[15] The FSC put the same argument:

> 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.[16]

10.13 On the other hand, the ISN and the consumer groups defended the government's consultation on the annual disclosure requirement. The ISN was asked whether it—like others—was taken 'by surprise' that the annual fee disclosure requirement is to apply to existing clients. Ms Robbie Campo, Manager of Strategy at the ISN, told the committee:

> It took me by surprise that it took anyone by surprise, because I attended all of the consultation panel meetings and that idea had been discussed at the consultation meetings.[17]

10.14 Indeed, Choice noted in its submission that the idea of an annual disclosure notice was first discussed at a peak consultation group meeting led by Treasury on 24 January 2011. It observed that the disclosure requirement was raised:

> In response to the industry's concerns about annual opt-in consumer groups suggested that if opt-in was required every two years instead of annually then it would be reasonable for consumers to be told the amount they had paid in fees for services in the intervening year.
>
> It was raised and supported as a good faith attempt by those who strongly supported annual opt-in to find a way to meet the industry's concerns about an annual measure.[18]

10.15 Choice drew attention to the government's 28 April 2011 FOFA information pack which stated that the two year 'opt-in' requirement:

> ...will be supplemented by an intervening annual disclosure notice to be provided to the client detailing fee and service information for the previous

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15 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 41. See also Mr Dante de Gori, General Manager, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 44–45.

16 Ms Cecilia Storniolo, Senior Policy Manager, Financial Services Council, *Committee Hansard*, 23 January 2012, pp 35–36.

17 Ms Robbie Campo, Manager, Strategy, Industry Super Network, *Committee Hansard*, 24 January 2012, p. 23.

18 Ms Jenni Mack, Chair of Governance Committee, Choice, *Submission 69*, p. 1.

> and forthcoming year, informing the client of their right to ‘opt-out’ at any point in time to an ongoing advice contract.[19]

10.16 On 29 August 2011, Minister Shorten's press release stated that 'the 'opt-in' measure requires a financial adviser or planner to send a renewal ('opt-in') notice every two years to new clients, as well as *an annual fee disclosure statement to all clients*'.[20]

10.17 Choice did acknowledge that the draft legislation relating to disclosure notices did not apply to all clients, as the Minister’s press release had indicated. It was subsequently amended such that the measure applies as it was outlined in the government's April 2011 announcement.[21]

10.18 Associate Professor Joanna Bird from the University of Sydney argued that it is reasonable for a consultation process to amend the draft legislation. In her evidence to the committee, she reasoned:

> You consult with bodies because you want to get their opinion, and presumably you are going to be prepared to make changes if people make submissions to you that convince you. So we should not be surprised that, through the consultation process, the package of reforms has changed. It has to be said that this very group of consumers put forward a submission that actually argued that it should apply to all existing clients. That, and presumably other information that came to the government, may have convinced them that they needed to modify their legislation in response to it. That is what happens in consultation processes; arguments are made to you and you are convinced by them and you respond to them. If you are not prepared to change anything, do not consult.[22]

10.19 Associate Professor Bird also noted that the consultation process on the Bill is ongoing, through the parliamentary committee process. As she told the committee:

> ...the idea that this is not being consulted on is strange because we are talking about it and we are consulting on it. And there have been something like 68 submissions made to you [the committee] and many of them have raised this issue. So there is ongoing consultation.[23]

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19 Australian Government, 'Future of Financial Advice—Information Pack', 28 April 2011, p. 8. http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 1 February 2012).

20 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms— Draft Legislation', *Media Release No. 127*, 29 August 2011 http://mfss.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/127.htm&pageID=003&min=brs&Year=&DocType=0

21 Ms Jenni Mack, Chair of Governance Committee, Choice, *Submission 69*, p. 1.

22 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 59.

23 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 59.

Committee view

10.20 The committee rejects the suggestion put by some stakeholders that the first FOFA Bill's provision which require annual fee disclosure statements to be prepared for both existing and new clients was not discussed during the consultation process. While it is true that the draft Bill did not contain the requirement for existing clients, the intent to apply disclosure statements to both new and existing clients was publicly announced by the government in April and August 2011. The committee also highlights Treasury's comment that it consulted with stakeholders about the potential cost of the disclosure obligations.[24]

The implementation timeframe

10.21 As chapter 1 noted, the commencement date for the provisions of the FOFA Bills is 1 July 2012. The committee received mixed evidence on the merit of this starting date.

Opposition to the 1 July 2012 timeframe

10.22 Several witnesses proposed aligning the commencement of the FOFA and MySuper legislation. The AFA, the FPA, the Corporate Superannuation Specialist Alliance the FSC and ANZ Wealth[25] 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.[26] Beyond this, these groups' views varied on how the implementation of FOFA should proceed.

10.23 The Chief Executive Officer of the FPA, Mr Mark Rantall, told the committee that 'there should be a two-year transition and implementation time frame for the FOFA reforms similar to those that apply to FSR'.[27]

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24 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 63; Dr Richard Sandlant, Manager, Financial Advice Reform Unit, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p. 67.

25 Mr Richard Klipin, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 18;. Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 49; Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 76; Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 35; Mr Paul Barrett, General Manager, Advice and Distribution, ANZ Wealth, *Committee Hansard*, 24 January 2012, p. 2.

26 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. The Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 was introduced into the parliament on 16 February 2012.

27 Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 41.

10.24 The FSC drew the committee's attention to the costs of IT implementation and training, noting that its members need 'at the very least' a six- to nine-month period before they can start implementing the FOFA reforms. Mr John Brodgen, the Chief Executive Officer of the FSC, noted that in waiting 12 months to implement FOFA, 'the industry will be better prepared to provide best interest advice and adhere with this legislation'.[28]

10.25 The Corporate Superannuation Specialist Alliance told the committee that the FOFA legislation 'should not be delivered in numerous separate tranches as this makes it almost impossible for the financial services industry to plan appropriately for and to cost-effectively implement the changes'.[29]

10.26 The Stockbrokers' Association of Australia told the committee that with the July 2012 commencement date, its members 'will not have enough time to make the systems, policy and procedural changes which will be necessary for their implementation'. The Association sought a further transition period 'of at least 12 to 18 months, from July 2012 to the end of 2013'.[30]

Support for the 1 July 2012 commencement date

10.27 The Joint Consumer Groups (JCG) told the committee that the proposed transition provisions are 'actually quite generous'. It noted that under the intended arrangements, there will be no opt-in notice required until July 2014 and for new clients, the first fee disclosure statement will not be required until 1 July 2013.[31]

10.28 In its submission to the inquiry, ANZ Wealth set out its recommended approach to FOFA compliance deadlines. It proposed that the following aspects of the legislation should be implemented by 1 July 2012:

- the 'opt-in' requirement for new clients (which will not actually commence until 1 July 2014);
- the annual disclosure fee requirement (providing it is only prospective for new clients);
- the soft dollar ban;
- the Australian Securities and Investments Commission's (ASIC) new powers;
- the ban on conflicted remuneration as it applies to volume bonuses;

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28 Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 35.

29 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 76.

30 Mr David Horsfield, Managing Director and Chief Executive Officer, Stockbrokers' Association of Australia, *Committee Hansard*, 23 January 2012, p. 50.

31 Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 61.

- the ban on conflicted remuneration as it applies to workplace employer defaults (provided there is no enforcement activity for one year after 1 July 2012);
- the ban on conflicted remuneration as it applies to non-corporate super; and
- the best interests duty (with a three month grace period on enforcement in light of the final shape of the duty not being known and in recognition that systems changes will need to occur so that the duty is appropriately applied to adviser activities).[32]

10.29 ANZ Wealth argued that if the disclosure requirement applies to existing clients, the commencement date should be 1 July 2013. It also argued that the ban on conflicted remuneration as it affects Authorised Deposit-taking Institutions (ADIs) should wait until 1 July 2013, as should the ban on adviser commissions in group insurance arrangements.[33]

10.30 In terms of its own industry, ANZ Wealth drew the committee's attention to the 'substantial legacy systems and products' of many fund managers. In addition, it noted that there are current products that will fall into the legacy category as a result of the reforms.[34]

10.31 The ISN told the committee that there are in some cases substantial changes to be made to the operating systems of large institutions. Mr Whiteley suggested that the regulator should be aware of these transitional issues:

> I have certainly got sympathy that elements of some of these reforms mean that institutions are going to have very substantial system changes if they are required. I am not an expert on the system changes that are required, but certainly the evidence is suggesting from some of the major institutions a substantial amount of change is required and that the regulator, ASIC, should be sensitive to the implementation process.
>
> ...on the particular points around probably certain volume rebates and some of the complex areas around platforms, we are very much of the view that [the] regulator should be taking a constructive, sympathetic and I think the term is soft approach to that first year of implementation, to be respectful of and sympathetic to the fact that timelines are probably at little bit more pushed out and people might have expected and the industry does need to have the capacity to do this implementation.[35]

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32 ANZ Wealth, *Submission 29*, pp 5–7.

33 ANZ Wealth, *Submission 29*, pp 5–7.

34 ANZ Wealth, *Submission 29*, p. 4; Mr Paul Barrett, General Manager, Advice and Distribution, ANZ Wealth, *Committee Hansard*, 24 January 2012, p. 2.

35 Mr David Whiteley, Chief Executive, Industry Super Network, *Committee Hansard*, 24 January 2012, p. 24.

10.32 Treasury argued along similar lines. In evidence to the committee, Executive Director of Markets Group, Mr Jim Murphy, noted:

> ...for the major companies we appreciate that major systems changes have to take some time. There are ways of doing that. You can commence legislation but have a very light touch from ASIC, more an educational role. That is one way and not so much stringent enforcement. There are various ways of approaching that.[36]

10.33 In its supplementary submission to the inquiry, the ASIC noted that it had announced it will adopt a 'facilitative compliance approach' for the first 12 months of the implementation of the FOFA reforms. As an ASIC official explained:

> ...provided industry participants are making reasonable efforts to comply with the FOFA reforms, ASIC will adopt a measured approach where inadvertent breaches result from a misunderstanding of requirements or systems issues. However, where ASIC finds deliberate and systemic breaches we will take stronger regulatory action.[37]

10.34 In evidence to the Senate Economics Legislation Committee on 16 February 2012, Treasury noted that various representations had been made by the industry on the implementation timetable and a final decision was 'still with the minister'. This included whether to synchronise the starting date for the implementation of the MySuper and FOFA reforms. Mr Murphy did note that there will need to be 'quite important changes to back officers in terms of education of financial planners'.[38]

Committee view

10.35 The committee is cognisant that at the same time as it is preparing this report, the Minister is conducting ongoing consultations with the industry on the implementation timeframe for the FOFA Bills. The committee largely agrees with ANZ Wealth that the vast majority of the FOFA provisions should commence on 1 July 2012. The industry has been properly consulted and has known of the FOFA Bills' provisions for some time. The annual fee disclosure for new clients and the 'opt-in' requirement will commence in 12 months and two years respectively. The fee disclosure requirement for existing clients relates only to the client arrangements negotiated for the previous 12 months and as such, should not be onerous.

10.36 The committee does recognise, however, that where institutions face substantial systems changes, ASIC should show a measured approach to inadvertent

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36 Mr Jim Murphy, Executive Director of Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 64.

37 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 3. See also, Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, p. 76.

38 Mr Jim Murphy, Executive Director of Markets Group, Treasury, *Proof Committee Hansard*, Senate Economics Legislation Committee, Senate Estimates, 16 February 2012, p. 50.

breaches in the first year of the legislation. The committee commends ASIC for its 'facilitative compliance approach' but urges the regulator to adopt a stricter approach 12 months after the commencement of the FOFA provisions.

Cost of implementing FOFA

10.37 The FSC stated in evidence to the committee that based on modelling from the industry, the full implementation cost of FOFA will be $700 million. Mr Brogden added that on top of this cost, there will be an annual compliance cost of $375 million across the industry.[39] These estimates have been widely cited.

10.38 The $700 million implementation estimate was put to Treasury for its comment during Senate Estimates in February. Mr Murphy replied:

> I am very sceptical of that estimate...We are examining it...As well as that, we look at what other people say. From what I can glean from all the various estimates that have come out, it is going to have a marginal impact on the financial planning industry.[40]

The regulations

10.39 There was some concern that industry will have very little opportunity to see the regulations accompanying the legislation prior to the commencement date of 1 July 2012. Mr Brogden of the FSC told the committee:

> ...this will not go through parliament or through the House of Representatives until March, April or May...
>
> ...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.[41]

10.40 However, the committee notes Treasury's comment that it expects the draft regulations will be available for public consultation during March 2012. This will give the industry at least three months in which to comment on the draft regulations and know of their final form.[42]

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39 Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 30.

40 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, Senate Economics Legislation Committee, Senate Estimates, 16 February 2012, p. 53.

41 Mr John Brodgen, Chief Executive Officer, Financial Services Council, *Committee Hansard*, 23 January 2012, p. 35.

42 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p. 64.

Concluding comments and a final recommendation

10.41 The FOFA Bills represent a significant reform of the financial advice industry in Australia. The impetus for the legislation was the committee's 2009 inquiry into financial products and services in Australia. That inquiry was in turn a response to the financial collapses of Storm Financial and Opes Prime, among others. As in the 2009 inquiry, the committee's principal interest in examining the FOFA legislation is to ensure better outcomes and protections for consumers of financial products and services. It believes that the legislation will achieve that aim.

10.42 The FOFA Bills will not only enhance consumer protections, but promote the professionalism of the financial advice industry. For too long, the industry's standards have suffered from lax regulation and an inadequate focus on the needs and interests of clients. The FOFA reforms will significantly address these inadequacies, principally through the annual fee disclosure, opt-in and conflicted remuneration provisions. The costs of implementation and compliance for the industry will be far outweighed by the benefits to consumers from high quality advice and transparency in charging fees.

10.43 The committee does appreciate that the next 18 months to two years will be a time of significant adjustment for many in the financial advice industry. It recognises that ASIC will take a measured approach to inadvertent breaches in the first year of implementation. As this report has noted, it is also important that ASIC assist with this compliance through publishing clear regulatory guidance detailing what is expected of industry.

10.44 Moreover, the committee believes that in the interests of identifying problems with compliance and implementation, the government should commission an independent review of the FOFA reforms. The reporting of this review should be staggered to allow an initial assessment of the annual fee disclosure requirement and the industry's early adaptation, followed by a more complete assessment to consider the opt-in provisions and ASIC's use of its new powers.

Recommendation 15

10.45 The committee recommends that there should be an independent review of the application of the Future of Financial Advice (FOFA) legislation. The review should be timed to comment constructively on how stakeholders have complied with, and interpreted the FOFA provisions. To this end, the committee recommends that an initial report should be given to government by the end of 2013 and a further report by the end of 2014.

Mr Bernie Ripoll, MP

Chair

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

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

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.
>
> **Senator CORMANN:** …My question is: why?
>
> **Mr McNamara :** In regard to those RISs, essentially the impact analysis was not at a standard that we would pass.
>
> **Senator CORMANN:** You say 'the impact analysis'. Can you be a bit more specific?
>
> **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.
>
> **…**
>
> **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?
>
> **Mr McNamara:** Yes. There were six elements.
>
> **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—
>
> ...
>
> **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

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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

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.

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]

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]

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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:

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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**

Appendix 1

Submissions

1 Mr Bernie O'Connor

2 Ms Jo Tuck

3 Suncorp General Insurance

4 Mr Rod Longmire

5 Sequal Pty Ltd

6 Local Knowledge

7 Mr Richie Parsons

8 Stockbrokers Association of Australia

9 Confidential

10 Australasian Securities Dealers Association

11 Burrell Stockbroking and Superannuation

12 Industry Super Network

13 Chartered Secretaries Australia Ltd

14 Abacus - Australian Mutuals

15 Financial Ombudsman Service

16 Trustee Corporations Association of Australia

17 Professional Investment Services

18 Australian Institute of Superannuation Trustees

19 IOOF Holdings Limited

20 Associated Advisory Practices

21 The Association of Superannuation Funds of Australia Limited

22 The Treasury

23 Joint Accounting Bodies

24 Confidential

25 Joint Consumer Groups

Supplementary Submission

26 Money Solutions Pty Ltd

27 SMSF Professionals' Association of Australia Limited

28 ASIC

29 ANZ Wealth

30 Corporate Superannuation Specialist Alliance

33 Mr Brian Williams, iFinancial Solutions

34 Consumers' Federation of Australia

35 Gold Coast Tourism Corporation Ltd

36 Classic Holidays

37 Australian Financial Markets Association

38 AustralianSuper

39 Insurance Council of Australia

Supplementary Submission

40 Mr Russell Tym

41 Moneywise Global Pty Ltd

42 Matrix Planning Solutions

43 AMP Financial Services

44 LifeNet(WA) Financial Advice Pty Ltd

45 Australian Timeshare and Holiday Ownership Council Ltd

46 Wyndham Vacation Resorts Asia Pacific Pty Ltd

47 The Holiday Club

48 Boutique Financial Planning Principals Group

49 Paradigm Advice

50 FYG Planners Pty Ltd

52 Superpartners Pty Ltd

53 The Trust Company

54 Accord Vacation Club

55 Law Council of Australia

56 Queensland Tourism Industry Council

57 Mr Tim Wiedman, McCullough Robertson Lawyers

58 Financial Services Council

59 National Insurance Brokers Association of Australia

60 Vanguard Investments Australia Ltd

61 MLC and National Australia Bank

62 Financial Planning Association of Australia Limited

63 Accommodation Association of Australia

64 The Westpac Group

65 Macquarie Bank Limited

66 Association of Financial Advisers Ltd

67 Australian Bankers' Association Inc

68 Mr Robert Ross

69 Choice

Answers to Questions on Notice

1 Answer from the Treasury to written questions on notice and question taken at public hearing, 24 January 2012, Sydney. Received 10 February 2012.

2 Financial Ombudsman Service: Intra-fund disputes. Received 15 February 2012

3 Financial Ombudsman Service: Annual Review 2008-9. Received 15 February 2012

4 Financial Ombudsman Service: Annual Review 2009-10. Received 15 February 2012

5 Answers from the Australian Securities and Investments Commission to questions taken at public hearing, 24 January 2012, Sydney. Received 28 February 2012.

Additional information received

Financial Ombudsman Service, Timeshare disputes, received 13 February 2012

Appendix 2

Public Hearings

Monday 23 January 2012

Witnesses

AMP Financial Services

Mr Craig Meller, Managing Director

Mr Alastair Kinloch, Director, Government Affairs

Association of Financial Advisers

Mr Richard Klipin, Chief Executive Officer

Mr Bradley Fox, National President

Mr Philip Anderson, Chief Operating Officer

Mr Michael Nowak, QLD State Director

Mr Michael Carter, Head of IOOF advice division

Australian Bankers' Association

Mr Steven Münchenberg, Chief Executive Officer

Ms Diane Tate, Policy Director

Financial Services Council

Mr John Brogden, Chief Executive Officer

Ms Holly Dorber, Senior Policy Manager

Ms Cecilia Storniolo, Senior Policy Manager

Financial Planning Association

Mr Mark Rantall, Chief Executive Officer

Mr Dante De Gori, General Manager, Policy and Government Relations

Dr Deen Sanders, Chief Professional Officer

Mr John Bacon, General Manager, Professional Standards

Stockbrokers Association of Australia

Mr David Horsfield, Chief Executive Officer

Mr Doug Clark, Policy Executive

Joint Consumer Representatives

Associate Professor Joanna Bird, Joint Consumer Group, representing the Australian Shareholders' Association, the Australian Investors Association, Choice, Consumer Action Law Centre, Council on the Ageing and the National Information Centre on Retirement Investments

Mr Christopher Zinn, Director of Campaigns and Communications, Choice

Professional Investment Services

Mr Grahame Evans, Group Managing Director

Ms Bianca Petrik, Corporate Development Manager

Associated Advisory Practices

Ms Soula Cargakis, General Manager

Boutique Financial Planning Principals Group

Mr Claude Santucci, President

Corporate Superannuation Specialist Alliance

Mr Douglas Latto, President

Mr Gareth Hall, Treasurer

Tuesday 24 January 2012

Witnesses

ANZ Wealth

Mr Paul Barrett, General Manager, Advice and Distribution

Mr Allan Hansell, Senior Manager, Government and Regulatory Affairs

Mr Mark Pankhurst, Head of OneAnswer and Employer Super

Association of Superannuation Funds of Australia

Ms Pauline, Chief Executive Officer

Ms Fiona Galbraith, Senior Policy Adviser

Industry Super Network

Mr David Whiteley, Chief Executive

Mr Matthew Linden, Chief Policy Adviser

Ms Robbie Campo, Manager, Strategy

Abacus

Mr Mark Degotardi, Head of Public Affairs

Wyndham Vacation Resorts and Australian Timeshare and Holiday Ownership Council (ATHOC)

Mr Barry Robinson, CEO Wyndham Vacation Resorts and President, ATHOC

Financial Ombudsman Service

Mr Shane Tregillis, Chief Ombudsman

Mr Ian Donald, Legal Counsel

Joint Accounting Bodies

Mrs Keddie Waller, Policy Adviser, Financial Planning, CPA Australia

Mr Hugh Elvy, Head of Financial Planning, Institute of Chartered Accountants Australia

Mr Reece Agland, Manager Member Integrity, Institute of Public Accountants

The Treasury

Mr Jim Murphy, Executive Director, Markets Group

Ms Sue Vroombout, General Manager, Retail Investor Division

Dr Richard Sandlant, Manager, Financial Advice Reform Unit, Retail Investor Division

ASIC

Mr Peter Kell, Commissioner

Mr John Price, Senior Executive Leader

Ms Delia Rickard, Senior Executive, Consumers, Advisers and Retail Investors

Appendix 3

Conflicted remuneration: technical amendments requested

Organisation and reference	Argument	Amendment requested
Financial Planning Association, *Submission 62*, p. 21. (discussed further below)	***Clarification on fee-for-service*** In order to provide clarification and certainty that all forms of 'fee-for-services' arrangements are permissible provided there is client consent, irrespective of how the payment is facilitated the FPA recommends that s963B(1)(d) is amended.	The benefit is given to the licensee or representative by, or with the agreement consent or authority of a retail client in relation to: i) The issue or sale of a financial product by the licensee or representative to the client; ii) Financial product advice given by the licensee or representative to the client;
Australian Bankers Association, *Submission 67*, p. 31. (discussed further below)	***Ensuring ADI carve-out applies to employees***	Section 963D should be amended to clarify that the carve-out relates to a benefit paid by a licensee or representative to their "employee". Additionally, the Explanatory Memorandum should be amended to clarify that "work carried out" relates to all forms of salary including wages and entitlements, either nondiscretionary or discretionary, as stipulated in the contract or agreement of the "employee".
Westpac Group, *Submission 64*, p. 28.	***Third party IT software will not be considered exempt*** In the case where a product manufacturer has a third party create software on their behalf, the software should be considered exempt from the bans on conflicted remuneration. Some product issuers do not have the relevant skills or expertise in IT, or may not be able to build the software as efficiently as an external supplier. So in some circumstances, outsourcing the software or IT support services may be more prudent.	The IT exemption be amended so that the exemption apply whether the product issuer builds the software itself or uses a third party supplier.

AMP Financial Services, *Submission 43*, pp 22-23; Financial Services Council, *Submission 58*, p. 81; Australian Bankers Association, *Submission 67*, p. 37.	***Licensees cannot directly provide software and support to their representatives*** The wording of the Bill seems to preclude licensees from providing IT support and services as a benefit to their representatives as the carve-out is limited only to the 'benefit provider'**.**	The Bill should be amended to remove 'by the benefit provider'. Additionally, paragraph 2.39 of the Explanatory Memorandum should be expanded to refer to "representatives" and not only "authorised representatives" in order to clarify that a licensee can provide professional development to all of its representatives without breaching the conflicted remuneration provisions.
Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 5.	***Licensee 'loophole'*** Payments are only banned from being made when they flow from employer to employee, from licensee to authorised representative and from product issuers to licensees or representatives. Licensees who are not product issuers or sellers will still be able to pay conflicted remuneration (the 'licensee loophole') and this opens the way for artificial structuring of remuneration arrangements where an entity is interposed.	
Law Council of Australia, *Submission 5*, p. 9.	***Definition of conflicted remuneration too general*** 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.	Product and service fees accumulated as a result of general advice be specifically excluded from the definition of conflicted remuneration in the forthcoming regulations.

Westpac Group, *Submission 64*, p. 25; Financial Services Council, *Submission 58*, pp 60-61.	***Definition of Funds Manager*** The definition of "funds manager" includes any licensee or RSE licensee that deals in a financial product to which the platform is related. As a result "funds manager" includes, for example, both general and life risk insurers. In effect, the elements of the definition of "funds manager" in section 9641(1) are sufficiently broad to capture any financial services licensee or RSE licensee including for example an insurer. The definition would capture a licensee even if the licensee does not: • Issue the product; or • Manage the product. The definition would capture a licensee even if the product is not: • A managed fund; or • Any other kind of investment product. For example, the definition of "funds manager" would include a financial planner who is arranging for an insurance product to be issued to a client.	Westpac suggest a new definition of funds manager: "funds manager means a responsible entity of a registered scheme or an RSE licensee who issues their financial products to retail clients through the platform operator's custodial arrangement by having them available on the investment menu of the custodial arrangement." FSC recommend that s964 should define the terms used in s964A as follows: a) "funds manager" means the issuer or manager of an investment product available through a custodial arrangement, excluding an issuer or manager who is in the same wholly owned corporate group as the platform provider b) "funds manager's financial products" means financial products issued by the funds manager that are held by or through the custodial arrangement by or on behalf of retail clients .
MLC and National Australia Bank, *Submission 61*, pp 9-10.	***Individuals caught up in group life insurance*** The precise definition of 'group life policy' at s963B(2), could result in 'individual' arrangements being captured by the ban. It should be noted that the terms 'group insurance' and/or 'group life policy' are not explicitly defined in law. Thus, while they typically refer to an arrangement purchased for a group of persons (such as an employer group or an industry association), they may also refer to arrangements entered into with superannuation trustees which enable access for individual members to insurance benefits. For example, group life policies (or master policies) may be issued to the trustee for an individual member in the Fund.	A new section 963B(2A) be inserted: An insurance arrangement within a group life policy: a) that is an insurance interest issued in respect of an individual member at the request of that individual member; and b) that insurance interest is not part of or an increase to a benefit to the member referred to in 963B(3)(b), is deemed not to be a group life policy for members of a superannuation entity for the purposes of section 963B(1).

Law Council of Australia, *Submission 5*, p. 12.	***Unintended consequences for superannuation trustees*** A platform operator is defined by reference to custodial arrangement, many superannuation trustees will be deemed as platform operators under this definition. It appears that fund managers are not able to offer wholesale asset management fees to platform operators unless the difference between the wholesale rate and the "rack" rate paid by other investors can be justified as a reasonable assessment of the costs the fund manager will save by offering its product through the platform. As a consequence, this means that any rebates which have been negotiated by these superannuation trustees would be prohibited under the new legislation, especially if the amount of the rebate exceeds any efficiency savings of the kind referred to in section 964A(3)(b). In this regard, it is critical to note that some large superannuation funds are able to negotiate very favourable rebate arrangements which in some cases will far exceed mere efficiency savings. The crucial distinguishing factor in the context of superannuation funds (as opposed to other platform operators) is that superannuation trustees are required by law to hold all rebates for the benefit of their members and cannot retain those rebates for their personal benefit.	The Bill should specify that any discounts or rebates be passed on to the consumer and that trustees of superannuation funds be excluded from the definition of platform operators.
Financial Services Council, *Submission 58*, p. 62.	***General and life risk insurance caught in volume based shelf space fees*** Section 964(1) of the legislation has the potential to catch general insurance and life risk insurance payments which fit the broad definition of a volume based shelf space fees. This ban is contrary to announced policy in the April 2011 announcement where the Government stated that the ban on volume payments "will not apply to pure risk insurance".	The definition applicable to s964A be expressly narrowed to a fund manager and platform/custodial arrangement. Alternatively, life risk and general insurance should be carved-out from the ban on volume based shelf space fees (similar to the carve-out for conflicted remuneration).

Financial Services Council, *Submission 58*, p. 77.	***Additional or expanded exemptions for both monetary and non-monetary benefits*** Further clarity is required in the wording of the Bill	The ban on conflicted remuneration should expressly not apply to: a) Benefits that are: • not caught, • caught but exempt, or • caught but grandfathered. for example, fee for service amounts paid by the client based on funds under advice are not caught by the prohibition (nor should it be). However, a bonus scheme paid by the licensee or employer that was based on the aggregate of such fee for service revenues generated by the adviser would be banned because it depends in part on funds under advice. b) Exempt benefits: any advice about general insurance, basic banking products and exempt life insurance, regardless of who is giving the advice or paying the benefit. Currently, advice remuneration on these products is only exempt when the advice or the benefit is provided by the product issuer. There is no policy reason why these exemptions should not extend to where a benefit is paid by someone other than the product issuer in respect of general insurance or the specified life insurance – particularly given that those advisers are likely to be less conflicted than the product issuers themselves.

Financial Services Council, *Submission 58*, p. 79.	***Sale of a financial adviser business*** While the sale of a business is the sale of an asset, that asset includes a register of clients and their product holdings. The valuation therefore has a connection with the number of products held by those clients. Such connection should be divorced from application of the definition of conflicted remuneration by way of a specific exemption. A financial planner should be able to sell their business to their licensee without that sale and any subsequent sale by that licensee, being considered conflicted remuneration simply because the nature of the business involves financial products**.**	The purchase and sale of financial planning businesses as between licensee and its authorised representatives be specifically exempt from 963B.
Australian Bankers Association, *Submission 67*, pp 35-36.	***Fee-for-service arrangements do not include client to bank exchanges*** Subsection 963B(1)(d) aims to exempt payments agreed directly between a client and the adviser. The EM clarifies that the provision intends to exclude benefits “given” by: • A retail client directly; • By another party at the direction of the retail client; or • With the clear consent of the retail client. The expanded interpretation of “given” contained in the EM should be contained in the Bill. Additionally, where the “adviser” is employed by a bank, the payments will be made to the bank, not directly to the adviser. Therefore, the Bill should recognise that the benefits may be given by the client to the employee indirectly.	Subsection 963B(1)(d) should be amended to clarify that the benefits may be given by the client to the employee indirectly so that asset based fees are not conflicted remuneration even where the fees are paid through an investment facility. Specifically, the law should be redrafted as follows: “the benefit is given to the licensee or representative by, at the direction or with the clear consent of, a retail client...” Subsection 963B(1)(d) should be amended to clarify that the benefits may be given directly or indirectly to an “employee”. Specifically, the law should be redrafted as follows: “the benefit is given to the licensee or representative by, at the direction or with the clear consent of, a retail client in relation to: the issue or sale of a financial product by the licensee or representative to the client; or financial product advice given, whether directly or indirectly, by the licensee or representative to the client.”

Australian Bankers' Association, *Supplementary Submission 67*, p. 9	***Sophisticated businesses*** Many businesses which meet the requirements to be considered as a "retail client" often require products in order to facilitate day-to-day business operations (i.e. foreign exchange contracts, derivatives and commodity products within the agricultural industry and manufacturing industry). Therefore, these products are not investment products, and are not used for speculative purposes. Instead, these products are used by business customers for risk management and hedging purposes, e.g. managing a financial risk to their business which they may be exposed to as a result of undertaking the business (i.e. fluctuations in prices and interest rates).	For certainty a subsection should be inserted into section 963B to deem that a payment made in relation to a transaction for the purposes of hedging/risk management is not conflicted**.**
Australian Bankers Association, *Submission 67*, pp 34-35.	Business to business transactions: white-labelling White labelling, as a commercial arrangement, tends to relate to agreements that a bank may have with other providers – typically other banks or subsidiaries of other banks – to provide the system or infrastructure that underpins the provision of a financial product. prohibiting legitimate business-2-business payments that relate to the distribution of products and/or services via white labelling arrangements (internally within a conglomerate banking group and externally) is unnecessary. In the instances of these white labelling arrangements, such advice is unlikely to occur because the customer does not receive personal advice, the payment of fees is not related to the provision of personal advice, and the customer has a choice to use the system or facility, or not. The ABA is concerned this would likely result in these important services being remodelled or withdrawn given the restriction on such business-2-business payments.	The provisions should be drafted to exempt general advice given by way of general market information, such as marketing material, market reports and market data