The Senate

Economics Legislation Committee

Corporations Amendment (Future of Financial Advice) Bill 2011 [Provisions]

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

March 2012

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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

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

Bill 2 – Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

BFPPG - Boutique Financial Planning Principals Group

BSS - Burrell Stockbroking and Superannuation

CCI - Consumer credit insurance

CSS - Corporate Superannuation Specialist

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

LCA – Superannuation Committee, Law Council of Australia

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

Glossary[1]

Adviser	A person who provides financial advice to a retail client and is an Australian financial services licensee; or a representative of an Australian financial services licensee.
Annual Fee Disclosure	A requirement (proposed by the Bill) for an adviser to send a client a statement outlining all ongoing fees and charges paid by the client for the previous 12 months, and the fees scheduled for the forthcoming 12 months.
Asset-based fee	A benefit based on a percentage of a client's funds under advice.
Authorised Deposit-taking Institution	Authorised Deposit-taking Institutions (ADIs) are corporations which are authorised under the *Banking Act 1959*. ADIs include banks, building societies and credit unions.
Basic banking products	The Bill proposes to define 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; (e) any other product prescribed by regulations for the purposes of this paragraph.
Best interests duty	A general duty (proposed by the Bill) that advisers must act in the best interest of their clients supplemented by a series of steps advisers can take

[1] Terms for this glossary have been adapted from: definitions throughout the body of this report; Australian Securities and Investment Commission, 'Regulatory Guide 146: Licensing: Training of financial product advisers', December 2009; ASIC, Regulatory Guide 175, 'Licensing: Financial product advisers – Conduct and disclosure', April 2011; SuperGuide: Simple independent superannuation information, 'Intra-fund advice', http://www.superguide.com.au/superannuation-topics/intra-fund-advice (accessed 3 February 2012); the *Corporations Act 2001*; InvestorWords.com, http://www.investorwords.com/2128/fund_manager.html (accessed 7 March 2012; and the *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

	in order to meet this duty. The advice given must be appropriate to the client and the adviser must give priority to the client's interests in the event that there is a conflict between the interests of the client and those of the adviser.
Conflicted remuneration	Product commissions that may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients.
Execution-only	Where a product or service is sold with no advice provided to a retail client.
Financial product	Generally a facility through which, or through the acquisition of which, a person does one or more of the following: - makes a financial investment - manages financial risk - makes non-cash payments.
Financial Services Guide	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.
Funds manager	The individual(s) responsible for making decisions related to any portfolio of investments (often a mutual fund, pension fund, or insurance fund), in accordance with the stated goals of the fund.
Geared	The use of borrowed funds to increase an investment portfolio.
General advice	The current law defines general advice as 'financial product advice that is not personal advice'.
Group life/risk insurance	Group life insurance is a structural arrangement where a trustee of a superannuation fund purchases life insurance from a life company on behalf of a group or class of members. This approach is intended to provide administrative and cost benefits for trustees and their members.
Intra-fund advice	Intra-fund advice is personal superannuation 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.
Licensee	The holder of an Australian Financial Services

	License (AFSL). Throughout this report this term can also include the employees and representatives of a licensee.
Opt-in	The Bill proposes a renewal notice be provided by advisers to clients every two years requesting clients to 'opt-in' to the continuing ongoing fee arrangement. If a client does not renew, or 'opt-in' in writing, within a 30 day period, the agreement between the client and the adviser is terminated.
Personal advice	The current law defines personal advice as: 'financial product advice that is given or directed to a person (including by electronic means) in circumstances where: (a) the provider of the advice has considered one or more of the person's objectives, financial situation and needs; or (b) a reasonable person might expect the provider to have considered one or more of those matters'.
Platform operator	Can be thought of as a one-stop shop or supermarket for managed funds and other financial instruments. Licensees and large dealer groups can use the product lists generated by platform operators to advise their clients.
Product manufacturer	The manufacturer of a financial product.
Representative of a licensee	May include: - an authorised representative of the licensee; or - an employee or director of the licensee; or - an employee or director of a related body corporate of the licensee; or - any other person acting on behalf of the licensee.
Scaled advice	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).
Shelf-space fees	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.
Statement of Advice	A document that 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.
Tier 1 products	All financial products except those listed under Tier 2 products.

Tier 2 products	General insurance products, except for personal sickness and accident, consumer credit insurance, basic deposit products, non-cash payment products, FHSA deposit accounts.
Trail commission	A form of on-going commission received by advisers from product providers for placing clients with particular products, often paid as a percentage of funds under management.
Un-geared investments	Investments that do not use borrowed amounts.
Volume-based fee	The commission an adviser receives upon sale of a certain type or a certain volume of products.

Recommendations

Recommendation 1

2.38 The committee recommends that regulations for the Corporations Amendment (Future of Financial Advice) Bill 2011 provide for minimum disclosure guidelines outlining what must be included by providers in the annual Fee Disclosure Statement.

Recommendation 2

2.39 The committee recommends that a revised Explanatory Memorandum to the Corporations Amendment (Future of Financial Advice) Bill 2011 be issued, which explains in further detail how the Fee Disclosure Statement will apply to existing clients.

Recommendation 3

4.27 The committee recommends that regulations pertaining to proposed 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.

Recommendation 4

4.50 The committee recommends that Treasury consult with corporate superannuation specialist firms to discuss alternate models of remuneration in alignment with the FOFA reforms.

Recommendation 5

7.8 The committee recommends that the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended to preclude the timeshare product from the bans on conflicted remuneration.

Recommendation 6

8.12 The committee recommends that the use of asset-based fees be closely monitored by the Australian Securities and Investments Commission (ASIC) post implementation of the Future of Financial Advice Bills. ASIC's findings should contribute to the proposed independent review of the Future of Financial Advice reforms (see recommendation 9).

Recommendation 7

9.19 The committee recommends that further material be provided in the Explanatory Memorandum and regulations 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; and**
- **specific examples of IT support and software that are banned, and not banned.**

Recommendation 8

9.26 The committee recommends that the regulations for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 should not place a domestic requirement on the conflicted remuneration exception provided for genuine education and training benefits. Paragraph 2.33 of the Explanatory Memorandum should be amended accordingly.

Recommendation 9

11.56 The committee recommends that independent reviews of the Future of Financial Advice reforms are conducted in 12 and 24 month intervals following the commencement of the FOFA Bills. The reviews should consider the measures taken by the Australian Securities and Investments Commission in response to the new measures as well as industry's compliance with the provisions of the FOFA Bills.

Recommendation 10

11.57 The committee recommends that, subject to the above recommendations, the FOFA Bills should be passed.

Chapter 1

Introduction and background

1.1 The Corporations Amendment (Future of Financial Advice) Bill 2011 (Bill 1) was referred to the Senate Economics Legislation Committee (the committee) on 3 November 2011.[1] The Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Bill 2) was referred on 25 November 2011.[2] The committee was asked to inquire and report on the bills by 14 March 2012. The two bills are intended to implement the Future of Financial Advice (FOFA) reforms announced in April 2010.[3]

1.2 On 13 October 2011, the House of Representatives referred Bill 1 to the Parliamentary Joint Committee on Corporations and Financial Services (PJC).[4] Bill 2 was referred to the PJC on 24 November 2011.[5] The PJC tabled its report on 29 February 2012.[6] The PJC received 69 submissions and held two public hearings in Sydney on 23 and 24 January 2012, where it took evidence from 26 different organisations.

1.3 The committee received 52 submissions to its inquiry. Only 7 of these organisations/individuals did not also make submissions to the PJC. A list of those who made submissions to this inquiry can be found at appendix 1.

1.4 Given the considerable uncertainty and concerns expressed among industry participants regarding the FOFA reforms, the committee decided to conduct additional hearings to those of the PJC on 23 and 24 February 2012, where it took evidence from 18 different organisations. A list of those who appeared before the committee can be found at appendix 2.

1.5 In its deliberations, the committee has also taken into consideration the evidence provided to the PJC.

1.6 The committee thanks all those who provided evidence to this inquiry.

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1 *Journals of the Senate No. 63*, 3 November 2011, p. 1735.

2 *Journals of the Senate No. 72*, 25 November 2011, p. 1961.

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

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

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

6 *House of Representatives Hansard*, 29 February 2012, p. 72.

The bills

1.7 Treasury outlined that the main objectives of the bills are twofold, to ensure that financial advice is in the client's best interest, and that financial advice is accessible to those who would benefit from it.[7]

1.8 The bills amend the *Corporations Act 2001*. Bill 1 contains two key FOFA measures:

- a requirement for providers of financial advice to obtain client agreement to ongoing advice fees every two years and enhanced annual disclosure of fees and services associated with ongoing fees; and
- enhancements of the ability of the Australian Securities and Investments Commission (ASIC) to supervise the financial services industry through changes to its licensing and banning powers.

1.9 Bill 2 contains further FOFA measures, including:

- the imposition of a best interests duty on financial advisers, requiring them to act in the best interests of retail clients when providing personal financial product advice;
- a ban on financial advisers receiving remuneration which could reasonably be expected to influence the financial product advice provided to retail clients;
- a ban on the charging of asset-based fees (fees calculated as a percentage of client funds under advice or management) on the borrowed monies of retail clients; and
- a ban on volume-based shelf-space fees from funds managers to administration platform operators.[8]

Background to the inquiry

1.10 The two bills represent the government's response to the PJC's 2009 inquiry into financial products and services in Australia. The PJC examined the collapse of some high profile financial product and service providers, including Storm Financial and Opes Prime. The PJC found that:

> A better regulatory framework for managing financial advisers' conflicts of interest is needed. The product distribution role of financial advisers—and the remuneration they receive from product providers for recommending certain financial products—too often leaves consumers getting advice that is not in their best interests. The law needs to explicitly state that financial advisers must place their clients' interests ahead of their own. The committee has recommended that the Corporations Act be amended to include a fiduciary duty requiring advisers to put their clients' interests first.

7 Treasury, *Parliamentary Joint Committee Submission 22*, p. 1.

8 Treasury, *Parliamentary Joint Committee Submission 22*, pp 2-3.

> The committee believes that payments from product providers to financial advisers, such as commissions and volume bonuses, create entrenched conflicts that are very difficult to manage. The committee has therefore recommended that the government consult with industry on the most appropriate way to cease payments from product manufacturers to financial advisers.
>
> ...
>
> Recent collapses have also shown the need for more effective regulatory enforcement. The committee has recommended that ASIC be appropriately resourced to perform effective risk based surveillance of advice provided under licence and perform financial advice shadow-shopping exercises annually. We recognise that it is often difficult for ASIC to take action when it identifies problems.[9]

1.11 The government has made two announcements regarding the FOFA reforms.

Initial announcement and industry consultations

1.12 The government's initial reform announcement on 26 April 2010 supported nine of the PJC's eleven recommendations and proposed several additional measures. Four of the PJC's recommendations were taken up directly in the government's reform package as part of the bills including:

- the introduction of a statutory fiduciary duty for advisers to act in their clients' best interests;
- strengthening the enforcement power of ASIC to ban individuals from the financial services industry;
- extending ASIC's discretionary powers to deny an application, or suspend or cancel a license, where there is reason to believe that the licensee is likely to contravene their obligations under the license; and
- ceasing payments from product manufacturers to financial advisers.

1.13 The recommendation to cease payments from product manufacturers to financial advisers was strengthened to include a ban on commission payments and payments relating to volume or sales targets, as well as banning percentage-based fees on geared investments.[10]

1.14 A consultation process was conducted by Treasury throughout the first phase of development of the FOFA reforms. The peak consultation group comprised key industry and consumer stakeholders, as well as ASIC. Public information sessions

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9 Mr Bernie Ripoll, *House of Representatives Hansard*, 23 November 2009, pp 12499-12500, http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/2009-11-23/0127/hansard_frag.pdf;fileType=application%2Fpdf (accessed 27 February 2012).

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

were held in June and July 2010 and February and March 2011 in Adelaide, Brisbane, Melbourne, Perth and Sydney.[11] In addition, the government announced the establishment of an advisory panel on financial advice and professional standards as part of its FOFA reforms.[12]

Second FOFA announcement and further consultation

1.15 The government announced, and released additional information, on the FOFA reforms on 28 April 2011.[13] The information package outlined modifications to several elements of the reforms previously announced including:

- extending the ban on conflicted remuneration to include 'soft dollar' benefits over a certain threshold (proposed to be $300);
- 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.[14]

1.16 On 29 August 2011 the government released exposure draft legislation for Bill 1.[15] Consultation on this exposure draft closed on 16 September 2011, with 47 submissions received.[16]

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

12 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.

13 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, '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).

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

15 This included details on the statutory best interests test, opt-in, and the enhancement of ASIC's powers. The best interests provisions were subsequently included in Bill 2.

16 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).

1.17 On 28 September 2011 the government released exposure draft legislation for Bill 2 which included the proposed ban on conflicted remuneration. Consultation on this exposure draft closed on 19 October 2011, with 48 submissions received.[17]

Support for the consultation process

1.18 Broadly, there has been support for the consultation process undertaken by Treasury, although there have been differences of opinion about when the inclusion of annual fee disclosure requirements was discussed. This element is discussed more fully in chapter 2.

1.19 Treasury noted the importance of wide consultation and discussion in implementing important reforms:

> We understand that to introduce this there are twists and turns and people have different arrangements. As I said in estimates, I think it is a good thing that these things are discussed before these committees and people get the opportunity to air their views. We are trying to take these on board so that we can give the best advice to the government.[18]

1.20 Associate Professor Joanna Bird, representing the Joint Consumer Groups, noted that:

> The consumer groups applaud the government's efforts to deal with these problems through improved regulation. They also applaud the government and the parliament's extensive consultation on the issues.[19]

1.21 Mr John Brogden, Chief Executive Officer of the Financial Services Council, also recognised the extent of the consultation:

> We have made it very clear that FoFA is a package of legislation as a result of a long period of consultation and discussion, the majority of which we clearly support and in some areas we have advocated for.[20]

1.22 Whilst the Financial Planning Association was generally supportive and noted 'the numerous consultation meetings and discussions hosted by Treasury with the peak consultation group, as well as individually with the minister's office, for which we are

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17 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).

18 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 23 February 2012, p. 30.

19 Associate Professor Joanna Bird, University of Sydney on behalf of Joint Consumer Groups, *Proof Committee Hansard*, 23 February 2012, p. 53.

20 Mr John Brogden, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 1.

very appreciative', they found overall that the reform process 'has been lengthy and disjointed.'[21]

1.23 The Association of Financial Advisers, were less satisfied by the process and felt that whilst the consultation process was long, the agenda ended up being 'hijacked, by sectional interests and not in the national interest'.[22]

1.24 The committee felt that, despite some criticism from a few parties, the consultation around reforms as complex as those of the bills was of a generally high standard. Senator the Hon. Nick Sherry's comments captured the feelings of the committee when he commented to Treasury officials:

> As I said at estimates, I want to congratulate the officials. I know they are doing the work of government and so on. However, they have done an enormous amount of work over the last couple of years in this space, with the pressure, the consultation and everything else. I understand and appreciate that. I just want to acknowledge that. It is more than would normally be expected in the policy space.[23]

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21 Mr Dante de Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 33.

22 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 50.

23 Senator the Hon. Nick Sherry, *Proof Committee Hansard*, 23 February 2012, p. 25.

Diagram 1.1: Key dates of the FOFA reform process

Date	Event
23 November 2009	The Parliamentary Joint Committee on Corporations and Financial Services (PJC) tabled its report, 'Inquiry into financial products and services in Australia'.
26 April 2010	The then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, announced the FOFA reforms.
June / July 2010	Treasury held public information sessions.
24 November 2010	Government announced financial advice advisory panel membership.
February / March 2011	Treasury held further public information sessions.
28 April 2011	The Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, announced further detail on the operation of the reforms.
29 August 2011	Draft legislation and a draft Explanatory Memorandum for Bill 1 were released. Treasury received 47 submissions in response.
28 September 2011	Draft legislation and a draft Explanatory Memorandum for Bill 2 were released. Treasury received 48 submissions in response.
13 October 2011	Bill 1 was introduced into the House of Representatives and referred to the PJC for inquiry and report.
3 November 2011	Bill 1 was referred to the Senate Economics Legislation Committee for inquiry and report.
24 November 2011	Bill 2 was introduced into the House of Representatives and referred to the PJC for inquiry and report.
25 November 2011	Bill 2 referred to the Senate Economics Legislation Committee for inquiry and report.
29 February 2012	The PJC tabled its report, having held two hearings in Sydney and receiving 69 submissions.
14 March 2012	Committee report tabled, having held two hearings in Canberra and receiving 51 submissions.

The financial advice industry in Australia

1.25 In November 2009 the financial advice industry in Australia comprised over 750 adviser groups operating over 8,000 practices and employing around 18,200 people.[24] Advisers work for authorised businesses holding an Australian Financial Services Licence (AFSL) under the *Corporations Act 2001*. The financial services industry is overseen by ASIC, which is responsible for the granting and cancelling of AFSLs. An AFSL will specify the scope of financial services a business is authorised to offer.[25]

1.26 The majority of financial advisers work for one of the approximately 160 dealer groups currently operating in Australia. The largest 20 dealer groups hold roughly 50 per cent of the market share. Advisory dealer groups can be medium to large in size and operate similar to that of a franchise. Various other business models are used within the financial advice industry, including institutional-owned financial adviser firms with employed advisers and smaller, independent advisory firms with their own licence.[26]

1.27 According to recent survey data the 20 largest licensees had around 4.6 million retail clients in 2010, of which 1.5 million were considered 'active clients'.[27]

Structure of the report

1.28 This report has eleven chapters:

- chapter 1 has provided a brief introduction and background to the inquiry;
- chapter 2 canvasses the main arguments in support of, and in opposition to, the opt-in and annual fee disclosure provisions;
- chapter 3 examines the best interests duty;
- chapter 4 examines the evidence received on conflicted remuneration, pertaining to volume-based benefits;
- chapter 5 looks at the bans on conflicted remuneration on risk insurance products within superannuation;
- chapter 6 discusses the carve-out from conflicted remuneration provisions for ADIs providing advice on basic banking products;

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

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

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

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

- chapter 7 proposes a carve-out for the timeshare industry;
- chapter 8 examines the bans on asset-based fees on borrowed amounts;
- chapter 9 explores issues regarding the ban on non-monetary benefits;
- chapter 10 discusses ASIC's new powers; and
- chapter 11 explores the impact of the FOFA reforms on the financial advice industry and concerns relating to the implementation of the bills.

Chapter 2

Opt-in and Annual Fee Disclosure requirements

2.1 This chapter will examine the main arguments of those who gave evidence to the committee in regard to the opt-in provisions.

Content of the opt-in provisions

2.2 The opt-in provisions consist of two main elements, a requirement for consumers to 'opt-in' in writing for continued service from their adviser every two years and a requirement for advisers to provide their clients with a Fee Disclosure Statement (FDS) annually.

2.3 Division 3 in Part 7.7A of the Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) provides that where a fee relationship exists between a retail client and a financial adviser, and the client is paying ongoing fees for advice, financial advisers are required to issue two separate notices:

(a) An annual fee disclosure statement outlining all ongoing fees and charges paid by the client for the previous 12 months, and the fees scheduled for the forthcoming 12 months.

(b) A renewal notice provided by the adviser to the client every two years requesting the client to 'opt-in' to the continuing ongoing fee arrangement. If a client does not renew, or 'opt-in' in writing,[1] within a 30 day period, the agreement between the client and the adviser is terminated.

2.4 If these notices are not provided, the ongoing fee arrangement is terminated and the client is not obligated to pay the ongoing fee beyond the relevant 12 or 24 month period (section 962F). If the client does not respond to the biennial renewal notice, or decides not to 'opt-in' by responding within the relevant 30 day period, the ongoing fee arrangement is terminated (sections 962M and 962N).

2.5 An 'ongoing fee arrangement' is defined in section 962A of the Bill, and is any arrangement by an adviser giving personal advice to a retail client in which a fee is to be paid for a period of 12 months or more. The following are not considered ongoing fee arrangements:

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1 Paragraph 1.47 of the *Explanatory Memorandum,* Corporations Amendment (Future of Financial Advice) Bill 2011 notes that '[i]n terms of clients notifying the fee recipient in writing of their decision to renew or not renew the ongoing fee, this can be administered flexibly and by using a range of mediums and technologies. For example, the client can notify the fee recipient in a number of recordable forms, including by facsimile, email, SMS, or through an online facility', p. 14.

- a client is paying an adviser by instalments for advice that has already been provided before the arrangement is entered into (a payment plan);
- a client is only paying an insurance premium; or
- a payment that is classed as a product fee (subsections 962A(3)-(5)), to be defined in regulation.

Support for the opt-in provisions

2.6 Unlike many other professions or occupations, financial adviser fees may be charged to retail clients on an ongoing basis rather than as transactional or one-off payments for services fee.[2] This means that where ongoing fee arrangements are entered into, the deduction of fees from clients' accounts can continue indefinitely even if no ongoing advice services are provided, until the client actively chooses to terminate the fee arrangement. Treasury explained that the opt-in requirements are intended to address this issue:

> 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.[3]

2.7 Several stakeholders expressed strong support for the inclusion of the fee disclosure statement and renewal notice provisions in the Bill.[4] The Joint Consumer Groups (JCG) stated:

> Both the disclosure statement requirement and the renewal notice requirement are essential to the achievement of the objectives of the FoFA reforms. 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...The renewal notice requirement ensures that disengaged retail clients do not pay ongoing fees for little or no service.[5]

2.8 The Joint Accounting Bodies emphasised that these provisions will increase openness in the adviser-client relationship:

> Importantly, transparency and honesty are essential elements in a trusted relationship between a financial planner and a client. Implementing these

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

3 Treasury, *PJC Submission 22*, p. 5.

4 Industry Super Network, *Submission 5*, p. 2; Joint Consumer Groups, *Submission 41*, p. 2; Joint Accounting Bodies, *Submission 21*, p. 2; ASIC, *Submission 9*, p. 11.

5 Joint Consumer Groups, *Submission 41*, p. 2.

mandatory ongoing disclosure requirements will ensure that these principles are upheld in all client engagements.[6]

Concerns raised regarding the opt-in provisions

2.9 Several industry groups and large advisory firms expressed concern regarding the annual fee disclosure and renewal notice provisions in the Bill.[7] The committee also received submissions from some smaller firms and individual financial advisers concerned about the impact of the opt-in requirements on their businesses.[8]

2.10 The main points of concern raised by stakeholders were:

- the objectives of the opt-in system will already be accomplished by the new best interests duty and ban on conflicted remuneration;
- the information provided in annual fee disclosure statements is already provided in other documents;
- opt-in will be costly to implement and will reduce the accessibility of advice for consumers; and
- the retrospective application of the fee disclosure statement is unjustified.

Necessity of the opt-in provisions

2.11 Some industry stakeholders argued that two other FOFA measures, the proposed best interests duty for advisers and the ban on conflicted remuneration, will satisfy the objective of protecting consumers from being charged fees they are not receiving, hence making the opt-in system redundant.[9]

2.12 Stakeholders such as the JCG argued, however, that even with the proposed ban on conflicted remuneration and best interests duty, asset-based fees (i.e. a fee for service based on a percentage of the total funds under management) paid by clients on an ongoing basis could still mimic the undesirable effects of commission payments, making it crucial that clients are made aware of all ongoing fees they are being charged and have an opportunity to renew ongoing fee relationships.[10]

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6 Joint Accounting Bodies, *Submission 21*, p. 2.

7 Association of Financial Advisers, *Submission 31*, p. 10; Financial Planning Association of Australia, *Submission 20*, pp 6-9; ANZ Wealth, *Submission 40*, p. 3; Suncorp Group, *Submission 1*, pp 2-4; Professional Investment Services, *Submission 17*, pp 5-9.

8 Mr Richie Parsons, *Submission 4*, pp 1-4; LifeNet(WA) Financial Advice Pty Ltd, *Submission 32*, p. 3; MoneyLink Financial Planning, *Submission 12*, pp 2-3.

9 Financial Services Council, *Submission 18*, p. 22; Financial Planning Association of Australia, *Submission 20*, p. 6; Assoc. Prof. Joanna Bird, *Proof Committee Hansard*, 23 February 2012, pp 54–55.

10 Joint Consumer Groups, *Submission 41*, p. 3.

Concerns regarding the annual Fee Disclosure Statement

2.13 Several concerns were raised regarding the requirement for advisers to issue annual FDSs to any clients engaged in an ongoing fee relationship.

Replication of existing disclosure information

2.14 Numerous stakeholders noted that a lot of the information to be included in the annual FDS is already available to clients. The Financial Planning Association of Australia (FPA) explained that, at minimum, information about fees and charges are included in the Financial Services Guide (FSG) and Statement of Advice (SOA) for each client. Additionally, adviser fees paid by product providers and superannuation funds are disclosed in annual statements directly from the product provider to the client.[11] Industry stakeholders argued that as clients may have many financial products through different product providers, it would be an onerous and expensive administrative burden to make advisers collate all of these costs and deliver them to the client in a single document:

> 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.[12]

2.15 Consumer representatives, however, noted that existing disclosure through FSGs and SOAs is forward looking, rather than a record of fees that have been paid. Additionally, they claimed that the FDS will provide more accurate prospective information than current disclosure documents.[13]

2.16 Associate Professor Joanna Bird also stressed the importance of consumers being able to access a single document with consolidated fee information, including adviser fees paid through product providers, so as to give consumers a clear picture of all fees they are paying.[14]

Cost estimates

2.17 The committee draws attention to the large discrepancies in estimates of the cost of fee disclosure and opt-in requirements.

2.18 Rice Warner Actuaries, in a report cited in the Explanatory Memorandum to the Bill (the EM) and the Regulation impact statement, estimated that the cost of the

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11 Financial Planning Association of Australia, *Submission 20*, p. 10.

12 Burrell Stockbroking and Superannuation, *Submission 8*, p. 4.

13 Joint Consumer Groups, *Submission 41*, pp 11-12.

14 Associate Professor Joanna Bird, University of Sydney, *Proof Committee Hansard*, 23 February 2012, p. 57.

opt-in requirements would be $11 per client.[15] 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.[16]

2.19 The Association of Financial Advisers (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.[17]

2.20 The AFA produced a table outlining the various costs it estimated will be incurred as a result of the opt-in and FDS requirements (see Table 2.1 below):

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15 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.

16 Burrell Stockbroking and Superannuation, *Submission 8*, p. 3; see also Association of Financial Advisers, *Submission 31*, pp 7, 13.

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

Table 2.1: Opt-in and fee disclosure estimated costs

Staff	Cost per Hour	Hours - FDS Only Year	Cost FDS Year	Hours - Opt-In and FDS Year	Cost - Opt-In and FDS Year	Yearly Average
Admin Staff	$40	1	$40	2	$80	$60
Adviser	$120	0.5	$60	0.5	$60	$60
Total		1.5	$100	2.5	$140	$120

Source: AFA, *PJC Supplementary Submission*, p. 4.

Retrospective nature of the Annual Fee Disclosure obligations

2.21 A significant issue raised by stakeholders was the potential retrospectivity of the annual FDS requirements in the Bill. While the renewal notice obligations only apply to clients who enter into an ongoing fee relationship after the commencement date of the legislation (section 962D), the FDS requirement will apply to all existing ongoing fee relationships (section 962S).

2.22 Industry stakeholders raised concerns that the retrospective application of these obligations to all existing ongoing clients would be administratively difficult and expensive, particularly where ongoing fees are charged relating to financial products that predate computers.[18]

2.23 Additionally, submitters expressed confusion regarding the date from which existing clients would need to be issued with a FDS, and whether statements would need to be issued detailing the fees charged in the 12 months prior to the commencement of the FOFA legislation. In response to a question on notice from the Parliamentary Joint Committee on Corporations and Financial Services, Treasury confirmed 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.[19]

2.24 This indicates that financial advisers will be required to issue an FDS to existing clients with details of fees charged in the 12 month period prior to the anniversary date of the contract. For example, if a client began a financial relationship with an adviser on 15 July 2011, the financial adviser will be required to provide a FDS to the client, detailing all fees paid in the prior 12 months and for the forthcoming 12 months (from 15 July 2011 until 15 July 2012).

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18 Professional Investment Services, *Submission 17*, pp 6–7; AFA, *Submission 31*, p. 10.

19 Treasury, answer to question on notice from the PJC inquiry, 24 January 2012, (received 10 February 2012).

2.25 Treasury claimed in its evidence to the committee that the FDS requirement was always intended to be retrospective.[20] This view was hotly contested by other stakeholders, who claimed that the retrospective element of the requirement was introduced more recently.[21]

2.26 Stakeholders complained that the retrospectivity of this arrangement is unfair and should be removed.[22]

Lack of detail concerning what is to be included in Annual Disclosure Statements

2.27 Section 962H of the Bill outlines that a FDS must include information concerning all ongoing fees paid by and services provided to the client in the previous 12 months, as well as anticipated fees and services in the forthcoming 12 months. Subsection 962H(3) also stipulates that regulations may provide more detailed directions about specific information that may be required in these statements.

2.28 The Financial Services Council (FSC) contended that clarification be provided around the level of detail required about services provided is needed regarding what information is expected in a FDS, so as to provide clarity for advisers and ensure that compliance costs are minimised. Stakeholders, including the FSC, also argued that it would be onerous and probably not useful to provide information regarding anticipated fees and services to clients. [23]

Committee view

2.29 The committee is of the view that regulations should outline minimum disclosure standards and details required for the FDS, and that the formulation of these standards should ensure the statements are as comprehensible as possible for consumers. The committee believes that obligating advisers to provide details of expected future fees and services will help clients to make an informed decision about whether they are receiving value for money.

Concerns regarding the two-yearly Renewal Notice

2.30 The committee heard evidence from some adviser groups that an 'opt-in' system enforced by a compulsory renewal notice is unnecessary, and that the current

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20 Mr Jim Murphy, *Proof Committee Hansard*, 23 February 2012, pp 26–27.

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

22 See for example, Mr Dante De Gori, General Manager, Policy and Government Relations, *Proof Committee Hansard*, pp 37–38; and Mr Philip Anderson, Chief Operating Officer, and Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, pp 48–51.

23 Financial Services Council, *Submission 18*, pp 29–30.

'opt-out' arrangements, whereby clients are notified that they may cease an ongoing fee arrangement at any time, is sufficient to protect consumers.[24]

2.31 In addition to views that the renewal notice obligation is unnecessary, the committee also heard concerns regarding the possibility of clients inadvertently failing to respond to their renewal notice and consequently having their fee arrangements terminated.[25] Witnesses noted that where a fee relationship is terminated after a client's failure to 'opt-in', the obligation for the provider to supply advice is also terminated, leaving clients potentially exposed to sudden market events or other adverse circumstances:

> We have agreements that we are going to provide certain levels of service. Some of it is a monitoring service. If something goes wrong with their investment we have to contact them. If that 30 days goes past, then our obligation ceases to exist, therefore that client who may have inadvertently not completed that piece of paper—they might have been overseas or for whatever reason—we have no obligation.[26]

Concerns regarding ongoing fees paid after arrangements are terminated

2.32 Subsection 962F(3) of the Bill states that where an advice relationship has been terminated as a result of the client failing to 'opt-in' and that client still makes a fee payment after that time, the provider is not obligated to refund the payment immediately. A court may order for the payment to be refunded, however, if the provider knowingly or recklessly continued to charge an ongoing fee and it is reasonable to make the order (section 1317GA). The EM claims:

> A statutory right of a client to a full refund of any ongoing fee charged after a failure to discharge the disclosure obligation would, while simple in principle, potentially result in a disproportionate and unjust result at the expense of the fee recipient.[27]

2.33 The Financial Ombudsman Service argued that it would be fair for the legislation to provide for a refund of overpaid fees, and questioned the rationale provided behind subsection 962F(3).[28] The JCG concurred, arguing that the onus

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24 Burrell Stockbroking and Superannuation, *Submission 8*, p. 5; Professional Investment Services, *Submission 17*, p. 5; IOOF, *PJC Submission* 19, p. 5.

25 Burrell Stockbroking and Superannuation, *Submission 8*, p. 5; Professional Investment Services, *Submission 17*, p. 5.

26 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 12.

27 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 10.

28 Financial Ombudsman Service, *Submission 39*, p. 4.

should fall on the provider rather than the client to ensure that ongoing payments are not made.[29]

Committee view

2.34 The committee believes that the annual FDS and biennial renewal notice obligations are necessary reforms that will increase transparency about advice fees and allow consumers to make an informed choice about the fees and services their adviser is providing.

2.35 The provision of information regarding advice fees is currently sporadic and inconsistent across the industry, and the FDS will address this by providing consumers with a collated summary of all adviser fees they are paying. The two-yearly renewal notice will ensure clients are engaged with their advisers and are not paying for services they do not receive.

2.36 The committee is of the view that in order to provide clarity and certainty for industry about what level of detail should be included in the FDS, regulations should provide minimum disclosure guidelines outlining what is expected.

2.37 Additionally, the committee considers that the application of the FDS to existing clients is unclear in the EM, particularly regarding fees paid before the commencement date of the legislation.

Recommendation 1

2.38 The committee recommends that regulations for the Corporations Amendment (Future of Financial Advice) Bill 2011 provide for minimum disclosure guidelines outlining what must be included by providers in the annual Fee Disclosure Statement.

Recommendation 2

2.39 The committee recommends that a revised Explanatory Memorandum to the Corporations Amendment (Future of Financial Advice) Bill 2011 be issued, which explains in further detail how the Fee Disclosure Statement will apply to existing clients.

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29 Joint Consumer Groups, *Submission 41*, p. 18.

Chapter 3

Introduction of a statutory 'best interests' duty for financial advisers

3.1 One of the central elements of the Future of Financial Advice (FOFA) reform legislation is the introduction of a statutory obligation for advisers to act in the best interest of their clients. This measure was recommended in the 2009 Parliamentary Joint Committee on Corporations and Financial Services (PJC) report into Financial Products and Services in Australia,[1] and is a measure that has largely been supported by the advice industry.

Formulation of the 'best interests' provisions in the Bill

3.2 The 'best interests' obligation is contained in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill). The provisions relating to the best interest duty are contained in proposed new Division 2 in Part 7.7A of the *Corporations Act 2001* (the Act).

3.3 The best interests obligations are contained in several elements, including:

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

3.4 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.

3.5 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 who breach the best interests provisions are subject to civil penalties (sections 961K-961N). Subdivision G provides for the responsibilities of authorised representatives.

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1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services in Australia*, November 2009, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate_Committees?url=corporations_ctte/fps/report/index.htm (accessed 25 January 2012).

Authorised representatives who contravene the best interests provisions are also subject to civil penalties (section 961Q).

3.6 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)).

3.7 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:
>
> (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.

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

3.8 The Bill repeals sections 945A and 945B of the Act, which deal with conduct obligations for financial advisers. Section 945A 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. According to the Explanatory Memorandum (the EM) of the Bill, this requirement for advice to be appropriate to the client is retained in the new section 961G, while 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).[2]

3.9 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.[3]

Views on the best interests duty

3.10 The committee heard from stakeholders that they are generally supportive of the introduction of a best interests duty. Industry peak bodies such as the Financial Services Council (FSC) and Association of Financial Advisers (AFA), consumer groups and accounting bodies, as well as Treasury and the Australian Securities and Investments Commission (ASIC), all expressed in principle support for this measure.[4]

3.11 The committee heard that a significant portion of the financial advice industry already meets a 'client's best interests' standard when providing advice. The AFA 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.[5]

3.12 Submitters made many comments regarding the specific formulation of the best interests duty, which are discussed below. The issues raised included:

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

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

4 Association of Financial Advisers Ltd, *Submission 31*, p. 13; Financial Services Council, *Submission 18*, p. 41; Financial Planning Association of Australia, *Submission 20*, p. 16; Joint Accounting Bodies, *Submission 21*, p. 3; Associate Professor Joanna Bird, representing the joint consumer groups, *Proof Committee Hansard*, 23 February 2012, p. 53; ASIC, *Supplementary submission 9*, p. 12; Treasury, *PJC Supplementary Submission 22*, p. 3.

5 Association of Financial Advisers, 'AFA Code of Ethics', http://www.afa.asn.au/members_conduct_ethics.php (accessed 25 January 2012); Mr Dante De Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 32.

- whether or not the best interests provisions amount to a statutory fiduciary duty for advisers;
- how the new best interests obligation will interact with other general law and statutory requirements;
- whether the 'reasonable steps' provisions that will be inserted into the Act through subsection 961B(2), particularly the inclusion of paragraph 961B(2)(g), are sufficient to guide the provision of advice in clients' best interests;
- whether the best interests obligations will adequately facilitate the provision of limited or 'scaled' advice; and
- the proposed scope and operation of carve-outs from the best interest duty for basic banking and general insurance products.

Fiduciary duty vs. a duty of care

3.13 From the initial policy announcement of the FOFA reforms in April 2010, the expressed intent from government relating to the best interests obligation is that it should be a 'statutory fiduciary duty so that financial advisers must act in the best interests of their clients'.[6] Some submitters have argued, however, that the approach to the best interests duty in the Bill falls short of placing a fiduciary duty on advisers. 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.[7]

3.14 The Law Council of Australia (LCA) told the committee that the inclusion of the 'reasonable steps' provisions in subsection 961B(2) made the provisions more akin to a standard of care than to other fiduciary 'best interest' duties found elsewhere in legislation:

> There is quite a lot of case law and judicial and other comment on that concept of best interest, and yet when see that term used in the bill, effectively what it does is it introduces a list of steps which are going to be required to meet a duty of best interest to the client. But again, as lawyers, when we look at those steps we would say that they go to the standard of care which is to be owed by the advisers rather than what is to be meant by the term 'best interests'.[8]

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

7 The Trust Company, *Submission 14*, p. 11.

8 Ms Heather Gray, Chair, Superannuation Committee, Law Council of Australia, *Proof Committee Hansard*, 24 February 2012, p. 11.

3.15 The Industry Super Network (ISN) also considered that the steps outlined in subsection 961B(2) are unusual for a fiduciary-type duty and more similar to a duty of care.[9] The Joint Consumer Groups commented that this may cause uncertainty and unpredictability, stating:

> ...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.[10]

Interaction of the new duty with other obligations for advisers

3.16 The LCA explained that advisers in different sections of the financial services industry, such as superannuation fund trustees, may already be subject to conduct obligations when providing advice, and queried how the new best interests obligation would interact with these obligations:

> From a legal perspective, it is hard to see how advisers would balance their general law obligations and their obligations elsewhere in legislation. So, as the Superannuation Committee of the Law Council we are particularly concerned for superannuation fund trustees here. They will be looking at their Superannuation Industry (Supervision) Act obligations to act in the best interests of their beneficiaries. They are going to have to try and balance, when they are giving advice, all of these competing obligations. We think there is a significant lack of clarity.[11]

3.17 The Stockbrokers Association of Australia noted that stockbrokers' existing best interests obligations often exceed those proposed in the Bill, a situation which will cause regulatory confusion if not acknowledged in the current reforms.[12] The FSC argued that the disparate legal and conduct obligations placed on advisers would add to the complexity and cost of the new regime.[13] Westpac Group argued that in relation to existing general law obligations, the Bill should be amended to state that compliance with the new statutory best interests duty will be regarded as fulfilment of the general law obligations of advisers.[14]

Commentary on the 'reasonable steps' provisions in subsection 961B(2)

3.18 As noted earlier, the best interest duty is formulated in the Bill through a general duty for advisers to act in the best interests of their clients (subsection

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9 Industry Super Network, *Supplementary Submission 5*, p. 2.

10 Joint Consumer Submission, *Supplementary Submission 41*, p. 11.

11 Ms Heather Gray, Chair, Superannuation Committee, Law Council of Australia, *Proof Committee Hansard*, 24 February 2012, p. 11.

12 Mr David Horsfield, Chief Executive Officer and Managing Director, Stockbrokers Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 41.

13 Financial Services Council, *Submission 18*, p. 42.

14 Westpac Group and BT Financial Group, *Submission 37*, p. 13.

961B(1)) and a set of steps which advisers can follow in order to satisfy that duty (subsection 961B(2)). The EM to the Bill provides a rationale for this formulation, and states the following with regards to the process steps in subsection 961B(2):

> 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.[15]

3.19 Some stakeholders expressed concern about the wording of the provisions in subsection 961B(2). In particular, several stakeholders expressed concerns that the inclusion of paragraph 961B(2)(g), requiring advisers to take 'any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances', adds uncertainty for advisers trying to fulfil their best interests obligations and makes the other 'reasonable steps' in paragraphs 961B(2)(a)-(f) redundant. The FSC argued that the Bill:

> ...outlines, in detail, the provisions that are required to meet best interest duty and then it almost overrides all of them by adding anything else that is in the best interest of the client. Our concern is that it almost becomes impossible to meet the best interest duty when you have the ability for ASIC to come in over the top and say, 'You met (a), (b), (c), (d), (e) and (f), but we still think there is another area, which we'll define in our own terms, where we don't think that you have reasonably met the duties.'[16]

3.20 These stakeholders advocated the removal of paragraph 961B(2)(g) so as to achieve greater certainty for advisers in discharging the new best interests duty.[17]

3.21 This view was not held by all stakeholders. ISN argued that if the industry merely needs to complete a defined list of steps to fulfil their best interest obligation, such as those in paragraphs 961B(2)(a)-(f), the reform will not achieve its objective of raising professional standards in the industry.[18]

3.22 ASIC officials commented on the approach taken in the Bill to these provisions, noting that similar provisions in other parts of the Act go beyond a 'tick-a-box' approach in order to raise professional standards:

> The stark choice faced in policy terms is whether you want a purely tick-a-box approach or whether, in bringing this industry to a higher professional

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

16 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 2.

17 Mr Philip Anderson, Chief Operating Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 51; Ms Heather Gray, Chair, Superannuation Committee, and Ms Michelle Levy, Member, Superannuation Committee, Law Council of Australia, *Proof Committee Hansard*, 24 February 2012, pp 11–12.

18 Industry Super Network, *Submission 5 – Supplementary Submission 1*, p. 2.

> level, you would ask them to exercise a level of judgment commensurate with other professions. If you look at safe harbour provisions in other parts of the corporations law, a tick-a-box type approach is somewhat unusual and normally people are asked to exercise a degree of judgment. The safe harbour provisions that relate to directors' duties is probably a good example of that.[19]

3.23 Treasury confirmed in its evidence to the PJC inquiry that the inclusion of paragraph 961B(2)(g) was designed to avoid a situation where advisers could simply follow a 'tick-a-box' approach to fulfilling their best interests duty, and was not intended to make the obligation excessively onerous.[20]

Ability for advisers to offer scaled advice

3.24 One of the stated aims of the FOFA reforms is to increase the availability of limited or 'scaled' financial advice to consumers. The EM states that the best interests obligation has been drafted in such a way as to allow advisers to provide scaled advice within the confines of a best interest duty.[21] Treasury explained how these provisions are intended to operate:

> 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.[22]

3.25 Despite this, industry groups expressed concern that the current drafting of the best interests duty in section 961B does not align with the policy intent, and is prohibitive to the provision of scaled advice.[23] The concern expressed by industry is that under the Bill providers may have to undertake a holistic review process of a client's finances, at considerable time and expense, even when the client wishes to receive only limited advice regarding one aspect of their finances or investment strategy. The FPA stated:

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19 Mr John Price, Senior Executive Leader, Strategy and Policy, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 20.

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

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

22 Treasury, *PJC Supplementary Submission 22*, p.4.

23 Association of Financial Advisers Ltd, *Submission 31*, p. 13; Association of Superannuation Funds of Australia, *Submission 26*,p. 3; AMP Financial Services, *PJC Submission 43*, p. 17; Westpac Group, *Submission37*, p. 15; Professional Investment Services, *Supplementary Submission 17*, pp 5–6.

> The concern with the way it is couched in the current bill is that an interpretation that is absolutely available is that it is a disincentive to scalable advice, and that in particular 961B(2)(g)—and I think that has been referenced already in some of the evidence provided this morning—imports an obligation to know all of the things about a client to be able to act in their best interest. Whilst we support the fundamental principle of that, we think it is a challenging expectation.[24]

3.26 The FSC argued that the legislation should expressly state that scaled advice is allowed under the best interests duty by allowing advisers and clients to agree on the scope of advice.[25] The Stockbrokers Association of Australia agreed that the legislation should clarify the scope of enquiries advisers must make in the provision of scaled advice:

> Both the government and ASIC have stated that in implementing the FoFA regime they aim to facilitate the provision of scaled advice to retail clients. To achieve this the act should be clear that the full fact-find of the client's relevant circumstances should not be necessary for every piece of advice.[26]

3.27 Some industry stakeholders disagreed, however, claiming that the best interests duty as currently drafted is compatible with the provision of scaled advice, and achieves the right balance between protecting clients and providing certainty to advisers by providing steps to demonstrate compliance.[27] For example, the ISN told the committee that the FSC proposal to allow the scope of advice to be agreed to by the adviser and client would limit advisers' legal obligations in a way that is not permitted under the current law:

> We strenuously disagree with the notion that an adviser and client can agree on the scope of advice, because the advisers' legal responsibilities flow from the determined scope of advice. To allow agreement is in effect to allow contracting out of an adviser's responsibility. It is important to note that under the existing obligations it is inconsistent with the existing obligations to reach agreement with a client on scope. So, not even under the existing legal obligations is that practice permitted. For that to be permitted under a best interest obligation, that would be a dilution when compared with the existing obligations.[28]

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24 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 34.

25 Financial Services Council, *Submission 18*, pp 45-47.

26 Mr David Horsfield, Chief Executive Officer, Stockbrokers Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 40.

27 AustralianSuper, *Submission 11*, p. 2; Industry Super Network, *Submission 5 – supplementary submission 2*, p. 2.

28 Ms Robbie Campo, Manager, Strategy, Industry Super Network, *Proof Committee Hansard*, 23 February 2012, p. 20.

3.28 Treasury stressed that the emphasis was on the adviser in determining whether or not scoping advice is in the best interest of the client:

> ...what we need to try to do is show the client, if they are only looking for scalable advice, can get that advice but so long as they provide certain information. Again, it is the obligation on the adviser to make a decision as to whether it is fair and reasonable for the client to get advice on a particular matter and not get holistic advice. When you think about the relationship, you can only impose that duty on the adviser. You cannot impose it on the client. Often the client does not really know what is in their best interests.[29]

3.29 Treasury agreed, however, that additional clarity is required regarding scaled advice in order to provide certainty for industry:

> ...the bill, as it is drafted, allows you to provide scaled advice. But that said, I can understand from the industry that they need as much clarity as possible on that, because it is an important aspect of their business...They need consolidated advice as to how they should operate. Whether that comes from the bill, the explanatory memorandum, ASIC guidance notes or some other arrangement, you just have to give them certainty. That is what needs to be considered, as to whether we have enough clarity out there in terms of scaled advice.[30]

3.30 The Australian Securities and Investments Commission confirmed to the committee that it intends to provide extensive assistance to providers wishing to operate in a scaled advice environment, through both regulatory guidance on the provision of scaled advice and extensive consultation with the industry.[31]

Carve-out for Authorised Deposit-taking Institutions on basic banking

3.31 The Bill proposes limited carve-outs from the best interests obligations for the provision of basic banking products and general insurance products. The EM provides a rationale behind these provisions:

> 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

29 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 23 February 2012, p. 30.

30 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Proof Committee Hansard*, 23 February 2012, pp 27-28.

31 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 19.

> obligation more appropriately balances the benefits to consumers with the compliance costs to providers.[32]

3.32 There was little discussion on the carve-out for general insurance, however, a number of submitters raised concerns regarding the proposed carve-out for Authorised Deposit-taking Institutions (ADIs) offering advice relating to basic banking products.

3.33 The proposed subsection 961B(3) provides that employees of ADIs offering advice relating to basic banking products only need to satisfy the steps in paragraphs 961B(2)(a)-(c) to satisfy the best interests duty. Under subsection 961J(2) advice provided on basic banking products is also exempted from the requirement in subsection 961J(1) where it is specified the provider is to give priority to the client's interests.

3.34 Treasury noted that currently, under section 945A of the Act, banks are required to adhere to regulations that determine appropriate advice. Some of the provisions of section 945A of the Act have been repealed and transferred across to the new provisions in paragraphs 961B(2)(a)-(c). Treasury explained that 'those steps that the banks used to be subject to under 945A they will continue to be subject to in the new legislation and they will also be subject to the appropriate advice test in the new legislation'.[33] The intention of this approach is 'to reflect as far as possible the banks' current position'.[34]

Claims that the carve-out is ambiguous and incomplete

3.35 The Australian Bankers Association (ABA) and Abacus – Australian Mutuals, however, do not believe the carve-outs reflect the banks' current position. ABA argued that applying paragraphs 961B(2)(a)-(c) of the Bill to ADIs providing advice on basic banking products will extend the obligations of ADI employees and representatives. Abacus – Australian Mutuals and ABA suggested that the proposed obligation may deter banks from providing personal advice, and some banks may even choose a 'no advice' model to avoid the uncertainty associated with the proposed obligations.[35] Abacus – Australian Mutuals commented:

> ...ADI frontline staff are not financial planners, but they can and do give financial product advice about simple, low-risk products. The existing personal advice provisions in the Corporations Act are complex enough and have encouraged many ADIs to adopt a no-advice model. Increasing

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

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

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

35 Australian Bankers Association, *Submission 23*, p. 6.

> regulatory complexity will only encourage more ADIs to adopt this model.[36]

3.36 Abacus – Australian Mutuals requested a 'clear and unambiguous carve-out' from the best interests duty for ADIs providing advice on basic banking products.[37]

3.37 Both Abacus – Australian Mutuals and the ABA suggested that section 945A in the Act should not be repealed on the basis that the current regulation allows for a more complete carve-out from the new best interests requirements for ADIs offering advice on basic banking products.[38] The ABA stated that instead of the obligations proposed by the Bill '[t]he existing provisions [in the Act] should be clarified to apply to basic banking products, general insurance products and products as prescribed by regulations'.[39]

Committee view

3.38 The committee agrees with the overwhelming support for the introduction of a statutory duty for advisers to act in the best interests of their clients. The committee believes that this is a necessary and overdue reform for the financial advice industry.

3.39 The committee acknowledges the concerns from some sections of the industry regarding the inclusion of paragraph 961B(2)(g), however, the committee believes the Bill strikes an appropriate balance between providing some certainty for industry while ensuring professional standards are raised.

3.40 The committee commends the Bill for promoting the provision of scaled advice. The committee notes the concerns from some sections of the industry that additional clarity is required to ensure that scaled advice can be provided. The committee draws the attention of Treasury to these concerns, noting also that ASIC's commitment to providing further guidance on scaled advice will assist the industry in implementing the new regime.

3.41 The committee agrees with the rationale that basic banking products are simple in nature and widely understood by consumers and therefore commends the exemption given on these products. The committee notes the concerns raised by the banking sector that the carve-out is not adequate. However, the committee considers that the carve-outs will indeed facilitate the provision of advice relating to these products.

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36 Mr Luke Lawler, Senior Manager, Public Affairs, Abacus – Australian Mutuals, *Proof Committee Hansard*, 23 February 2012, p. 2.

37 Mr Luke Lawler, Senior Manager, Public Affairs, Abacus – Australian Mutuals, *Proof Committee Hansard*, 23 February 2012, p. 1; Abacus – Australian Mutuals, S*upplementary Submission 6*, p.5.

38 Abacus – Australian Mutuals, S*upplementary Submission 6*, p.5; Australian Bankers' Association, *Submission 23*, p. 12.

39 Australian Bankers' Association, *Submission 23*, p. 13.

Chapter 4

Conflicted remuneration: volume-based benefits

4.1 The bans on conflicted remuneration target the negative effect of sales-incentives on the quality of advice. Traditionally advisers have received commissions from product providers for placing clients with particular products. The Explanatory Memorandum (the EM) to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill) discusses how commissions can influence advice:

> 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.[1]

4.2 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.[2] Payments banned include:

- certain product commissions to financial advisers and their dealer groups;
- volume payments from platform operators to financial advice dealer groups;
- volume-based shelf-space fees paid by funds managers to platform operators;
- asset-based fees on borrowed amounts;[3] 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.[4]

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

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

3 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 25.

4.3 The Regulation impact statement included in the EM noted the various remuneration models used by financial advisers. The EM detailed how the benefits are typically structured and the estimated percentage of adviser revenue for each form:

- trail commissions usually charged as 0.6 per cent of account balances (estimated at 35 per cent of adviser revenue);
- commissions on new investment/contribution typically charged at up to 4-5 per cent of the contribution (estimated at 26 per cent of adviser revenue);
- volume bonuses charged as an additional commission of up to 0.25 per cent of account balances; and
- fee for service arrangements charged at up to 1 per cent of account balances or as a flat fee perhaps based on the hours involved (estimated at 16 per cent of adviser revenue).[5]

4.4 The EM stated that '[p]lanners deriving no revenue from pure fee for service were more risk-orientated'.[6] The Regulation impact statement in the EM also noted the way in which different sorts of consumers engage with the various remuneration models, highlighting that low to middle wealth clients are more likely to be charged commissions than 'high net worth', sophisticated consumers :

> Remuneration models vary across organisations and according to the market segment to which a client belongs. Low to mid-wealth clients tend to pay initial and trail commissions, while 'high net worth' and 'affluent' clients tend to pay a greater proportion of service fees as a percentage of assets invested, or flat dollar adviser fees. This is most likely because wealthy clients are more sophisticated about how much the advice is costing, and more able to negotiate fees than less-wealthy clients. Wealthy clients tend to receive sophisticated treatment and periodic reviews from their advisers, while smaller customers tend to be offered simple strategies, packaged products and one-off sales. Again, this segmentation is likely based on both customers' needs and ability to pay.[7]

Exceptions from conflicted remuneration

4.5 There are some exceptions to the bans on conflicted remuneration including:

- general insurance;

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4 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30; Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 963C(b).

5 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 44–45.

6 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 45.

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

- life insurance which is not bundled with a superannuation product;
- 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);
- soft-dollar benefits that provide information technology software or support (also to be clarified in regulation);[8] and
- employees or agents of an Authorised Deposit-taking Institution (ADI) that are providing advice on basic banking products.[9]

4.6 Where it can be proven that the benefit of the payment is not conflicted, volume-based payments will also be precluded from the bans.[10]

Views of submitters

4.7 Broadly speaking, industry participants support the ban on conflicted remuneration and the policy goal to improve the integrity of the industry and increase consumer confidence in financial advisers. However, there were specific concerns raised in regard to the proposed conflicted remuneration provisions. This and the following five chapters address these concerns.

4.8 This chapter addresses issues relating to volume-based benefits including:

- the exceptions to volume-based fees;
- anti-avoidance provisions designed to prevent industry participants moving to vertically integrated structures to avoid bans on volume-based shelf-space fees; and
- bans on volume-based rebates and its subsequent impact on bank-tellers and corporate super-specialists.

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

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

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

Volume-based rebates

4.9 In the current regulatory environment advisers can receive benefits upon sale of a certain type or a certain volume of products; '[t]here are many incentives [for advisers] to meet volume-based or sales-driven targets'.[11] In addition to volume based payments paid directly by product providers and from licensees to their representatives, there are fees that flow to and from platforms in the form of volume-based shelf-space fees. This effectively creates a 'financial services value chain'[12] with commissions that flow from a fund manager (or product issuer), pass on to a platform, then to a financial advice dealer group and subsequently through to employees and representatives of the licensee.

4.10 Platform operators (or investor directed portfolio services) 'can also be thought of as a one-stop shop or virtual supermarket for managed funds and other financial instruments'. The platform operator will engage with financial product issuers to create a "platform" of products to offer advisers and financial advice dealer groups. Fund managers or financial product issuers will purchase shelf-space on a platform in order to receive preferential treatment for its product.[13]

4.11 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.[14] The Regulation impact statement in the EM noted

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11 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 46.

The Explanatory Memorandum 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.
Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 27.

12 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 48.

13 Jennifer McDermott, 'What's that: Shelf-space fees', *The Australian*, 9 June 2010, http://www.theaustralian.com.au/business/wealth/whats-that-shelf-space-fees/story-e6frgac6-1225875696291 (accessed 29 February 2012); see also *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 42.

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'.
Treasury, *PJC Supplementary Submission 22*, pp 8–9.

14 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 7, 25.

that these fees are interrelated 'where generally the fund manager pays the platform to sit on the investment menu and the platform pays the licensee to be on the approved product list and the licensee pays the planner for the recommendation of the platform'.[15]

4.12 The EM noted that benefits given by platform operators to financial advice dealer groups can take various forms:

> ...volume-based benefits can take numerous forms without appearing as a discernable payment from one entity to another. For example, some platform-dealer group arrangements involve a bundled fee which is paid by the client for administration or trusteeship services as well as distribution services which is then split between the platform and dealer group (with distribution to the latter sometimes labelled a 'promoter fee'). To the extent the share of the fee between the platform and dealer group is dependent on volume (which could reasonably be expected to influence financial product advice), any volume-based margin accessed by the dealer group would be treated as conflicted remuneration.[16]

Exceptions to volume-based fees

4.13 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 onus is on the platform operator to prove that any payment represents a reasonable fee for service or genuine scale efficiencies.[17]

Calls for greater restrictions on platform fees

4.14 The Joint Consumer Groups (JCG) and the Joint Accounting Bodies (JAB) argued that allowing certain platform benefits to continue creates risk that advice on financial products will continue to be distorted in these cases.[18]

4.15 JCG suggested that the exceptions for the bans on remuneration should be limited to fees for services that represent market value, the purchase price for property representing market value or genuine education or training benefits. In the case where the Bill allows volume-based benefits, JCG recommended that ongoing, public

15 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 48.

16 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 28–29.

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

18 Joint Consumer Groups, *Supplementary Submission 41*, p. 9; Joint Accounting Bodies, *Submission 21*, p. 8.

disclosure of all payments by product providers to platform operators be available on a publicly accessible website.[19]

4.16 JAB argued that when a volume-based benefit is permitted, where it represents a reasonable fee for service or value of scale efficiencies, the value of the benefit should be passed on to the end consumer.[20]

Proving fee for service and value of scale efficiencies

4.17 The Superannuation Committee of the Law Council of Australia (LCA) and Westpac Group and the BT Financial Group suggested that it would be difficult for a platform operator to prove that a volume-based benefit is not conflicted remuneration.[21] Westpac Group noted some of the difficulties that a platform operator would encounter demonstrating a volume-based benefit was not conflicted:

> 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.[22]

4.18 The Financial Services Council (FSC) argued that the discounts offered by fund managers are their intellectual property and a platform would therefore have difficulty requesting the relevant information:

> ...the arrangement that is provided to a platform or a super fund by a fund manager to benefit scale varies from one client to another. XYZ Fund Management may provide one discount here and provide a different discount to the next player. They may provide different investment services which also carry a different outcome. The risk is that you are effectively asking the fund manager to publicly disclose, through this reasonableness requirement, their IP, their intellectual property, that exists in their product.
>
> It is an extraordinarily competitive industry, fund management, as Senator Sherry knows. There is $1.8 trillion of funds under management. The largest single player, Colonial First State Global Asset Management manages $150 billion, of which $100 billion is Australian funds. There are very few other areas in financial services in Australia where the biggest player manages less than 10 per cent, so it is ruthlessly competitive, to the end benefit of the consumer. But it, therefore, critically involves different IP. If you are asking a fund manager to effectively open up the cupboard

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19 Joint Consumer Groups, *Supplementary Submission 41*, p. 9.

20 Joint Accounting Bodies, *Submission 21*, p. 8.

21 Law Council of Australia, *PJC Submission 55*, p. 10.

22 Westpac Group and BT Financial Group, *Submission 37*, p. 26.

> and say, 'Here's our profit margin and here's our IP', you are stripping out the competition in the game and you will see a disbenefit provided down the line to the individual client.[23]

4.19 Both the LCA and Westpac suggested that legislative guidance should be provided to inform platform operators how to prove that efficiencies have been gained, or that a volume-based benefit represents a reasonable fee for service. The LCA suggest that a materiality threshold should be included in the Bill to clearly determine which benefits are deemed conflicted remuneration and which are not.[24]

Permissible volume-based rebates should pass on to consumers

4.20 The Industry Super Network (ISN) and Vanguard Investments Australia argued that volume-based rebates should only be permitted in circumstances where the rebate is passed through to the end consumer. They argue that any form of volume-based benefit has cause to influence advice provided to consumers.[25]

4.21 There was some confusion over whether the Bill will allow for benefits to be passed through to the consumer. Vanguard expressed concern that the Bill creates a risk that existing practices where the benefit is passed on to the consumer may cease.[26]

4.22 The FSC asked that an amendment be made to the Bill to specifically ensure that volume-based benefits that are passed through to the end consumer are precluded from the bans:

> ...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.[27]

4.23 The LCA recommended that trustees of superannuation funds, who are already required by law to hold all rebates for the benefit of their member, should be excluded from the definition of platform operators. Alternatively, they too suggest an exception to the bans on volume-based fees that are received for the benefit of the retail client. [28]

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23 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 5.

24 Law Council of Australia, *PJC Submission 55*, p. 10; Westpac Group and BT Financial Group, *Submission 37*, p. 26.

25 Industry Super Network, *Supplementary Submission 5*, p. 4; Vanguard Investments Australia Ltd, *Submission 16*, p. 2.

26 Vanguard Investments Australia Ltd, *Submission 16*, p. 2.

27 Financial Services Council, *Submission 18*, p. 66.

28 Law Council of Australia, *PJC Submission 55*, p. 12.

4.24 In response to this uncertainty, 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'.[29]

Committee view

4.25 The committee sees that there is value in providing a materiality threshold in the regulations to the Bill to facilitate clear guidance for platform operators seeking to prove when volume-based benefits are not conflicted remuneration. The committee acknowledges the difficulties that platform operators will encounter gathering information from product issuers due to commercial in-confidence arrangements. These challenges should be taken into consideration when drafting a materiality (or quantitative) threshold.

4.26 In addition, the committee recognises that Treasury is acutely aware of the need to provide guidance and certainty to industry during these substantial reforms [30] and the Australian Securities and Investments Commission (ASIC) has undertaken to provide guidance material to assist the industry.[31] The committee recommends specifically that, as part of their guidance notes on conflicted remuneration, ASIC provide advice for industry participants on how to demonstrate when a volume-based payment represents a genuine fee for service or that value of scale efficiencies have been gained.

Recommendation 3

4.27 The committee recommends that regulations pertaining to proposed 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.

Vertical integration and anti-avoidance provisions

4.28 Professional Investment Services (PIS) voiced concerns that the provisions that ban volume-based benefits will foster an anti-competitive environment in which large, 'in-house' vertically integrated organisations will be favoured.[32] Associated Advisory Practices commented that 'the reality for independents, boutiques and smaller dealer groups is that these measures will increase the cost of providing

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29 Treasury, PJC answer to question on notice, 24 January 2012, (received 10 February 2012), p. 2.

30 Mr Jim Murphy, Head of Markets Group, Treasury, *Proof Committee Hansard*, 23 February 2012, p. 28.

31 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 19. ASIC has undertaken to provide guidance material on the best interests duty, conflicted remuneration and ASIC's new powers.

32 Professional Investment Services, *Supplementary Submission 17*, p. 9.

financial advice and reduce their capacity to operate profitable planning practices – at least on a level footing with the large players'.[33]

4.29 The ISN's preferred method to address this restructuring is to completely ban all volume-based rebates or alternatively, only allow benefits that are passed through to the end consumer.[34]

Anti-avoidance provisions

4.30 The government has responded to these attempts to avoid the bans with the inclusion of anti-avoidance provisions in the Corporations Amendment (Future of Financial Advice Measures) Bill 2011, 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).[35]

4.31 The Bill amends the new anti-avoidance provisions to capture a broader range of schemes designed to avoid the application of the FOFA reforms. Rather than only capturing incidents where 'the sole or dominant purpose' of the scheme is avoidance, the provisions will now capture incidents where 'avoidance is the sole or a non-incidental purpose of the scheme'.[36]

4.32 The LCA 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 if it commences operation on or after that date.[37] ANZ Wealth elaborated on this issue in their submission:

> The current scope of the anti-avoidance provision is so broad as to create uncertainty. For example, the provisions are not limited to the provision of financial advice and, on our reading, appear to also apply to grandfathering arrangements (where they apply). We recommend that this section be reviewed so that these anomalies are addressed.[38]

Committee view

4.33 The committee commends the prompt response that Treasury has made to address moves to avoid bans on conflicted remuneration, namely those relating to volume-based payments. The committee encourages Treasury to examine the

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33 Associated Advisory Practices, *PJC Supplementary Submission 20*, p. 2.

34 Industry Super Network, *Supplementary Submission 5*, p. 4.

35 Paragraph 1.61, *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice Measures) Bill 2011, p. 16.

36 Paragraph 2.69, *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 38.

37 Law Council of Australia, *PJC Submission 55*, p. 13.

38 ANZ Wealth, *Submission 40*, p. 3.

prospective application of the anti-avoidance provisions and the concerns raised by the LCA and ANZ Wealth.

Impact on bonuses for bank tellers

4.34 The Australian Bankers Association (ABA) and ANZ Wealth highlighted that, despite the carve-out for ADIs, volume-based benefits provided to banking staff could be captured in the bans. Some performance based bonuses for bank representatives relate to volume, or an aggregate net improvement in their client's net position. The ABA submits that these types of benefits are beyond the intent of the FOFA reforms and should be allowed as they can foster productivity, innovation and efficiency, and industry and global competiveness.[39]

4.35 Many banks use a balanced scorecard approach, which use both financial and non-financial measures to determine incentive eligibility. Non-financial measures may include customer satisfaction and quality, community engagement, culture and employee management, self-development, financial and risk management, and strategic process and quality.[40]

4.36 To allow for performance based remuneration models to continue, the ABA recommended that the Bill should be amended to 'exempt [volume-based] payments that are not 'wholly or directly' related to the value or number of financial products'.[41]

4.37 The EM to the Bill recognises the balanced scorecard approach as an acceptable remuneration arrangement:

> 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 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.[42]

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39 Australian Bankers' Association, *Submission 23*, pp 25–26; ANZ Wealth, *Supplementary Submission 40*, p. 4.

40 Australian Bankers' Association, *Submission 23*, p. 26.

41 Australian Bankers Association', *Submission 23*, p. 28. Section 963L of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 states that a benefit is conflicted unless it 'is *wholly or partly* dependent on the total value of financial products of a particular class'.

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

4.38 ANZ Wealth and the ABA, however, have requested that further certainty should be provided beyond the EM, and that it should be specified in the Bill that a balance scorecard approach to remuneration is permissible.[43]

Impact on corporate superannuation

4.39 It was highlighted to the committee that another group, corporate superannuation specialists, could also experience adverse and unintentional effects from the bans on volume-based benefits. The Corporate Superannuation Specialist Alliance (CSSA), which was formed in response to the proposed reforms in the sector, claimed that the bans would jeopardise the viability of the services they offer.[44] It argued that corporate superannuation specialists are unintentionally caught up in restrictions intended for financial planners.[45]

4.40 CSSA represents corporate superannuation specialist advisory businesses.[46] CSSA members provide advisory services to over one thousand corporate superannuation funds in Australia.[47] Corporate superannuation specialists engage in contracts with employers to provide newsletters and offer seminars in the workplace to educate employees.[48]

4.41 With a member balance of $30,000, the average cost per member for a corporate super fund is $90 to $100 per annum which provides the member access to personal advice in the form of:

- a dedicated corporate super adviser who assists Human Resources staff with implementation and attends the fund’s Policy Committee Meeting to guide the committee members through their responsibilities;
- 'member seminars that cover fund updates';
- 'access to face to face individual member consultations on site';
- 'a toll free line that gives members access to a qualified financial planner and administration support person'; and

43 ANZ Wealth, *Supplementary Submission 40*, p. 4, Australian Bankers' Association, *Submission 23*, p. 28.

44 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 7.

45 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 7.

46 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p.7.

47 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 7.

48 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 8.

- assistance to members and their families when making an insurance claim.[49]

4.42 Research conducted on behalf of the FSC in 2008 showed that CSSA member fees were 35 per cent lower than those of industry super funds. Members of large corporate super master trusts, with greater than $5 million in assets, paid fees of 0.79 per cent per annum, while industry member fund fees averaged 1.07 per cent.[50] The CSSA outlined that '[o]ne reason why the fees are so low in this sector of superannuation is that we have negotiated on behalf of our clients to reduce the fee that they pay'.[51]

4.43 Less than 10 per cent of corporate superannuation specialist firms receive remuneration directly from employers, the remainder receive income from fund managers[52] in the form of commission or volume based payments. The CSSA states that employers prefer the current form of remuneration for corporate superannuation specialists and do not want an additional expense on top of their super contributions.[53]

4.44 The CSSA outlined that if a fund channelled the benefits into an administration fund rather than remunerating a corporate superannuation specialist through an ongoing commission, the administration fee charged by the fund would not be transparent:

> 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.[54]

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

50 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 8.

51 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 8.

52 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *PJC Committee Hansard*, 23 January 2012, pp 81-82.

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

54 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *PJC Committee Hansard*, 23 January 2012, p. 77. For further assertions on the lack of transparency in intra-fund advice see Financial Services Council, *Submission18*, pp 69–74.

4.45 Corporate super specialists are affected by the bans on volume-based payments as well as the bans on benefits for group life insurance inside superannuation products (discussed in chapter 5).

Committee view

4.46 The committee acknowledges the concerns of both the banking sector and the corporate superannuation specialists given the proposed major reforms of the financial services industry.

4.47 However, the committee considers that the explanation in paragraph 2.19 of the EM to the Bill provides sufficient certainty for ADIs to continue to pay bonuses to staff using a balanced scorecard model of remuneration where 'remuneration could not reasonably be expected to influence the choice of the financial product recommended, or the financial product advice given'.[55]

4.48 Given the overwhelming concerns of the corporate superannuation specialist firms, and the need to re-structure their remuneration models, the committee recommends that Treasury consult with corporate superannuation specialist firms to discuss alternative models of remuneration in alignment with the FOFA reforms.

4.49 The committee encourages corporate super specialists to ensure that employers seeking their services are provided with a transparent overview of the costs and benefits of the different models of remuneration available in order for employers to adopt the method of remuneration most suitable to their circumstances following the reforms.

Recommendation 4

4.50 The committee recommends that Treasury consult with corporate superannuation specialist firms to discuss alternate models of remuneration in alignment with the FOFA reforms.

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).

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

Chapter 5

Risk insurance inside superannuation

5.1 Remuneration for general insurance and life insurance products outside superannuation is allowed under the provisions of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill). However, the following forms of remuneration are considered conflicted:

- group life insurance bundled with superannuation; and
- life insurance bundled with default superannuation.[1]

5.2 The April 2010 Future of Financial Advice (FOFA) announcement noted there would be forthcoming consultation on the potential to extend the bans on conflicted remuneration to risk insurance. The consultation process allowed for consideration of the Super System Review (Cooper Review). The final outcome, to ban insurance within superannuation is consistent with the Cooper Review's finding that insurance commissions within superannuation be banned as they influence the quality of advice provided to consumers. Treasury also noted the following benefits on the ban:

> - Consumers will have the freedom to pay for insurance advice, but won't be charged for services they don't receive.
> - Accessing insurance through superannuation will remain attractive as preferential tax arrangements will remain.
> - Those consumers who want alternative payment arrangements have the choice and flexibility of doing so outside the superannuation environment.[2]

5.3 There were two divergent views on the proposed bans on insurance within superannuation. A number of submitters argued that commissions on all risk products should be banned, including those outside superannuation, on the basis that the exception provided for insurance outside superannuation 'risks the continued provision, perceived or real, of inappropriate advice to consumers who seek advice on these products'.[3] The Joint Consumer Groups (JCG) believed this risk was heightened

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1 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 29.

2 *Future of Financial Advice Information Pack*, 28 April 2011, p. 7, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 29 February 2012).

3 Joint Accounting Bodies, *Submission 21*, p. 6; see also Industry Super Network, *Submission 5*, p. 2; Industry Super Network, *Supplementary Submission 5*, p. 4; Joint Consumer Groups, *Supplementary Submission 41*, p. 8.

by predictions that life risk insurance will be the product that is most likely to provide financial advisers with commission income following implementation of the Bill.[4]

5.4 Other submitters have argued, however, that the focus of the FOFA reforms has been financial planning, not risk insurance.[5] In addition, that the bans on commissions on insurance within superannuation will increase levels of under-insurance in Australia.[6]

5.5 The National Insurance Brokers Association of Australia noted that the 'risk insurance industry has not had the opportunity of a review similar to that undertaken in relation to...the financial advisory industry'.[7] The Association of Financial Advisers (AFA) questioned why risk insurance within superannuation had been banned, and recommended that a comprehensive review of retail, corporate and industry fund superannuation plans be undertaken where consideration is given 'to a sensible alternative remuneration model for insurance arrangements, where advice is provided'.[8]

5.6 Treasury expressed the view 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'.[9]

Remuneration for group life insurance inside superannuation

5.7 Group life insurance is a structural arrangement where a trustee of a superannuation fund purchases life insurance from a life company on behalf of a group or class of members. This approach is intended to provide administrative and cost benefits for trustees and their members.[10] The Financial Services Council highlighted the key benefits offered on insurance inside superannuation that are not available on offerings outside superannuation:

- administrative efficiencies for superannuation funds;
- access to group premium rates for members; and
- flexibility of Successor Fund Transfers (SFT).[11]

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4 Joint Consumer Groups, *Supplementary Submission 41*, p. 8.

5 National Insurance Brokers Association of Australia, *Submission 33*, p. 14.

6 FYG Planners Pty Ltd, *Submission 13*, p. 2; National Insurance Brokers Association, *Submission 33*, p. 16; IOOF Holdings Limited, *PJC Submission 19*, p. 4.

7 National Insurance Brokers Association of Australia, *Submission 33*, p. 14.

8 Association of Financial Advisers, *Submission 31*, p. 11.

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

10 Financial Planning Association, *Submission 20*, p. 20.

11 Financial Services Council, *Submission 18*, p. 57.

5.8 The Corporate Superannuation Specialist Alliance (CSSA) outlined further benefits of group life insurance within superannuation:

> With group insurance comes significant benefits, such as automatic acceptance, which allows cover to be provided to all members of the plan with no need for medical or other underwriting. It is automatic. This can be an enormous benefit to someone who may otherwise be uninsurable due to a past illness or accident. There is no churn with group insurance policies. There is no benefit to move between insurers unless there is a lower cost to benefit the members.[12]

5.9 A number of submitters argued that tailored advice is often provided on group life insurance within superannuation and therefore remuneration should be allowed in these instances.[13]

5.10 The Financial Planning Association suggested that commissions should be allowed:

- on the purchase of a group life insurance policy inside superannuation when a consumer seeks personal advice to access the premium group life policy rate; and
- where a client tops up their insurance needs on a group life policy arrangement inside superannuation (in this case the commission should only be payable for the individual, not from all members of the group life arrangement).[14]

5.11 The CSSA would also like to see the proposed ban on group life insurance lifted. Should the bans proceed, however, CSSA has suggested an alternative model: that a fee is charged to all members at an agreed percentage as negotiated with the client.[15] CSSA submitted that when no member-agreed fee structure is in place, the predetermined default for the membership should be set to zero. This would protect consumers from being charged a fee when no advice is provided.[16]

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12 Mr Gareth Hall, Board Member/Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 9.

13 ANZ Wealth, *Supplementary Submission 40*, pp 8–9; Corporate Superannuation Specialist Alliance, *Submission 48*, p. 3; Matrix Planning Solutions, *Submission 15*, p. 5.; FYG Planners Pty Ltd, *Submission 13*, p. 2; Financial Services Council, *Submission 18*, pp 54–55; Financial Planning Association, *Submission 20*, p. 20.

14 Financial Planning Association, *Submission20*, pp 20–21.

15 Corporate Superannuation Specialist Alliance, *Submission 48*, p. 3.

16 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *PJC Committee Hansard*, 23 January 2012, p. 80.

Regulatory arbitrage

5.12 IOOF Holdings highlighted the possibility that the Bill could create distortions between advice that is provided inside and outside superannuation 'even though the clients in both instances have obtained advice in relation to their insurance requirements'.[17] The AFA commented on the potential for distortions to occur between insurance offerings inside and outside superannuation:

> ...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.[18]

5.13 Ms Pauline Vamos of the Association of Superannuation Funds of Australia commented on the potential for regulatory arbitrage:

> Our policy position is that, where you have a compulsory system, particularly with SG payments, commission should be banned. Commission should be banned on superannuation guarantee. We have expressed our concerns that outside of SG where you have different requirements you have the risk of regulatory arbitrage. So, from a superannuation point of view, one of the possible concerns—one of the possible outcomes—is that you will have fewer people under group insurance in superannuation and outside of superannuation. The simple fact is the buying power of superannuation trustees, in terms of group insurance, is high, and so the premiums are low. We are concerned about potential regulatory arbitrage.
>
> ...
>
> The thinking behind the policy is very much that advisers in particular that are dealing in the superannuation space do provide clients with holistic services. The way in which the other parts of Stronger Super are framed, particularly around what services are provided to employers in particular, there is definitely an underlying policy to ensure that for services provided to employers, whether that be group insurance or other administration services, the employers pay directly, not through commission. So, the policy around group insurance and super supports that overall framework of

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17 IOOF Holdings Limited, *PJC Submission 19*, p. 4.

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

> MySuper. We understand why. We just want to make sure that any regulatory arbitrage issues are actually catered for going forward.[19]

5.14 The April 2011 FOFA information pack highlights that 'the broader impact of the ban on commissions within superannuation are areas that the Government will continue to monitor closely into the future'.[20]

Committee view

5.15 The committee recognises that the Bill must strike a balance between two equally important elements. Firstly, the Bill must provide essential consumer protections to guard against conflicted advice, ensuring advice is in the best interests of the consumer. Secondly, the Bill needs to ensure that advice on risk insurance is readily available to consumers both within and outside superannuation.

5.16 The committee acknowledges calls from submitters for a comprehensive review of insurance bundled with superannuation remuneration models, as well as the contrasting requests for all commissions on insurance products to be banned (including those outside superannuation). These conflicting views are somewhat representative of the tensions that must be addressed to both protect the interests of consumers and ensure adequate levels of advice are available.

5.17 The committee sees that this is a difficult balance to strike and recommends that a review of insurance offerings within superannuation is required post implementation of the FOFA reforms (see recommendation 10).

5.18 The review should take into consideration the evidence provided to this committee that suggests that tailored advice is often provided on group insurance inside superannuation. It should also consider the efficiencies gained for fund managers and the discounted rates made available to consumers on group life policies.

5.19 The Australian Securities and Investments Commission's supervision and findings on the sale of group life insurance should also contribute to the review.

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19 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 24 February 2012, p. 16.

20 *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 29 February 2012).

Chapter 6

The carve-out for ADIs providing advice on basic banking

6.1 This chapter will examine proposals in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill) that Authorised Deposit-taking Institutions (ADIs) receive a carve-out from the bans on conflicted remuneration when providing advice on basic banking products. The carve-out is conditional on an ADI representative providing financial product advice solely in relation to basic banking products and not in combination with, or in addition to, advice on non-basic banking products.[1]

6.2 Treasury asserted that the rationale for the carve-out is that basic banking products are 'simple in nature and are more widely understood by consumers' which means that 'there is a lower risk of consumer detriment in relation to the provision of advice on these products'.[2]

6.3 Submitters raised a number of issues in relation to the carve-out from the bans on conflicted remuneration for ADIs including:

- arguments that the carve-outs do not go far enough and create additional regulation for an already highly regulated sector;
- general insurance is not grouped within the list of basic banking products in the Bill, therefore 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; and
- whether consumer credit insurance (CCI) is included in the carve-out.

Requests to extend the carve-out

6.4 Whilst banking groups welcomed the carve-out, they also insisted that it did not go far enough. Abacus – Australian Mutuals, the Australian Bankers' Association (ABA) and ANZ Wealth argued that under current legislation the sector receives a high, and adequate, level of regulation. They voiced concern that the additional coverage proposed by the Future of Financial Advice (FOFA) reforms may reduce the availability of advice to consumers.[3] The ABA stated '[o]ur concern is that tellers and other bank staff are already under existing obligations and adding these further

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1 Treasury, *PJC Supplementary Submission 22*, p. 8.

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

3 Abacus – Australian Mutuals, *Supplementary Submission 6*, p. 8; ANZ Wealth, *Supplementary Submission 40*, p. 4; Australian Bankers' Association, *Submission 23*, pp 2, 5.

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'.[4]

6.5 In addition, the ABA noted that banks and banking groups are not part of the identified market failures in the financial services sector. It argued, therefore, that the carve-out for basic banking products should 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.[5]

6.6 In contrast, the Joint Consumer Groups (JCG) opposed the carve-outs for ADIs arguing that the rationale behind the carve-out is unclear and that the sale of basic banking products does not need to be encouraged with sales incentives:

> 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.[6]

General insurance

6.7 The carve-out 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 Explanatory Memorandum to the Bill (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'.[7]

6.8 Abacus – Australian Mutuals, ANZ Wealth and the ABA voiced concern that while general insurance is not subject to the broader ban on conflicted remuneration, bank representatives would not be permitted bonus pay when providing advice on general insurance in combination with, or in addition to, basic banking products, as

4 Mr Steve Münchenberg, Chief Executive Officer, Australian Bankers' Association, *PJC Committee Hansard*, 23 January 2012, p. 22.

5 Australian Bankers' Association Inc, *Submission 23*, p. 3.

6 Joint Consumer Groups, *Supplementary Submission 41*, p. 7.

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

general insurance is not considered a basic banking product in the provisions of the Bill.[8] Abacus – Australian Mutuals commented:

> ...we are concerned that the drafting of the carve-out from the ban on conflicted remuneration for ADI employees advising on basic banking products will prevent these employees advising on other simple products such as general insurance. General insurance is exempt from the ban on conflicted remuneration, so this outcome would make no sense.[9]

6.9 In contrast to the Australian Securities and Investments Commission's (ASIC) division of financial products (see table 6.1 below), general insurance is not grouped within the list of basic banking products proposed in the Bill. 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;
>
> (e) any other product prescribed by regulations for the purposes of this paragraph.[10]

8 Abacus – Australian Mutuals, *Supplementary Submission 6*, p. 6; ANZ Wealth, *Supplementary Submission 40*, p. 6, see also Mr Craig Meller, Managing Director, AMP Financial Services, *PJC Committee Hansard*, 24 January 2012, pp 6–7; Australian Bankers' Association, *Submission 23*, p. 8.

9 Mr Luke Lawler, Senior Manager, Public Affairs, Abacus – Australian Mutuals, *Proof Committee Hansard*, 23 February 2011, p. 1.

10 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, proposed amendments to section 961F of the *Corporations Act 2001*.

Table 6.1: ASIC's division of 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.

6.10 Abacus – Australian Mutuals and ANZ Wealth highlighted that if a bank representative wanted to retain a performance benefit when providing advice to a consumer on both a basic banking product and a general insurance product, the consumer would need to be referred to a separate member of staff.[11] ANZ Wealth argued that this will have unintended and detrimental outcomes for consumers, particularly in some of the smaller branch sites 'where there would not be a different staff member to deal with the insurance matter'.[12]

6.11 Abacus – Australian Mutuals recommended that the definition of basic banking product in the Bill should be aligned with Tier 2 products listed in ASIC Regulatory Guide 146 (see Table 6.1 above).[13]

6.12 The ABA recommended that paragraph 963D(b) of the *Corporations Act 2001* be amended to widen the carve-out so that bank representatives can receive a benefit when recommending a basic banking product in combination, or in addition to, a non-basic banking product. Namely, that the advice is *not solely* in relation to a basic banking product.[14]

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11 Abacus – Australian Mutuals, *Supplementary Submission 6*, p. 6;
ANZ Wealth, *Supplementary Submission 40*, p. 6;

12 ANZ Wealth, *Supplementary Submission 40*, p. 6.

13 Abacus – Australian Mutuals, *Supplementary Submission 6*, p. 6.

14 Australian Bankers' Association, *Submission 23*, p. 8.

Consumer credit insurance

6.13 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'.[15]

6.14 There were differing views and uncertainty amongst some submitters on whether CCI is deemed a general or life insurance product under the Bills and, therefore, whether the bans on conflicted remuneration apply to CCI.[16]

6.15 The JCG believed that the Bill does not consider CCI conflicted remuneration, and noted that that commissions paid on CCI is 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.[17]

6.16 The Insurance Council of Australia argued, however, that the ASIC report cannot be used as a basis for CCI to receive differential treatment under the FOFA reforms and that:

> ...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.[18]

6.17 In response to a request to provide clarification on how CCI will be evaluated under the Bills, Treasury stated that it is 'exploring this issue with industry'.[19]

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15 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, p. 112; see also ANZ Wealth, *Supplementary Submission 40*, p. 7.

16 ANZ Wealth, *Supplementary Submission 40*, p. 7; cf Joint Consumer Groups, *Supplementary Submission 41*, p. 7.

17 Joint Consumer Groups, *Supplementary Submission 41*, p. 7.

18 Insurance Council of Australia, *PJC Supplementary Submission 39*, p. 4.

19 Treasury, PJC answer to question on notice, 24 January 2012, (received 10 February 2012), p. 1.

Committee view

6.18 The committee commends the carve-out from the bans on conflicted remuneration given to ADIs providing advice on basic banking products. It believes this provision acknowledges the important service that banks provide and recognises consumer awareness that a bank is in the business of selling its own financial products. The committee is in agreement with the determination to limit the carve-out from the bans to basic banking only.

6.19 The committee recognises that the intent of the carve-out for ADIs providing advice on basic banking products 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'.[20] The committee sees that this approach is in alignment with the policy decision that the carve-out to ADIs is given on the basis that basic banking products are 'simple in nature and are more widely understood by consumers', which results in a lower risk of consumer detriment in the provision of advice for these products.[21]

6.20 The committee sees that qualified ADI representatives can continue to provide a high level of service and advice on non-basic products in combination with basic banking products where representatives are paid their ongoing set salary. In addition, the committee encourages ADIs to consider the use of non-financial measures to determine incentive eligibility for employees, including customer satisfaction and quality, self-development and strategic process and quality in these instances (see discussion on the balanced scorecard approach for ADIs in chapter 4).

6.21 In relation to consumer credit insurance, the committee considers that Treasury should provide guidance on the application of the conflicted remuneration bans on consumer credit insurance expeditiously. The committee strongly encourages Treasury to update the industry and Parliament on the status of its consultations before the Bill is considered by Parliament.

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

21 Treasury, *PJC Supplementary Submission 22*, p. 5.

Chapter 7

The timeshare industry

7.1 The timeshare industry provides vacations to members through a managed investment scheme structure. Accordingly, timeshare companies and their agents are required to hold an Australian Financial Services License (AFSL) and are, therefore, regulated by the *Corporations Act 2001* and overseen by the Australian Securities and Investments Commission. The major types of timeshare include:

- title-based timesharing schemes, whereby a person becomes a tenant in common with others;
- company structured timesharing schemes under which a person owns shares in a company that owns and operates a vacation resort;
- 'right to use' schemes, whereby a person acquires the right to occupy a resort but the developer retains ownership of the property;
- unit trust or other trust-based schemes under which a trustee acquires a property and holds it on trust for a defined period; and
- points-based timesharing schemes in which different classes of members hold different numbers of points which are redeemed for accommodation or other benefits.[1]

7.2 Timeshare issuers generally generate sales by employing authorised representatives to sell timeshare "lifestyle products". Commissions are the key mechanism for rewarding sales staff.[2]

7.3 A number of timeshare issuers, as well as the industry representative body, the Australian Timeshare and Holiday Ownership Council (ATHOC),[3] believed that the prohibitions on conflicted remuneration will unintentionally capture the commission-based tactics commonly used throughout the timeshare industry. Members of the industry have voiced concern that the provisions prohibiting conflicted remuneration will make the industry unviable.[4] Gold Coast Tourism and the Queensland Tourism Industry Council supported these arguments and noted that if the timeshare industry is

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1 Australian Timeshare and Holiday Ownership Council, *Submission 27*, p. 2.

2 The Holiday Club, *Submission 38*, p. 1; Wyndham Vacation Resorts Asia Pacific Pty Ltd, *Submission 30*, p. 3; Australian Timeshare and Holiday Ownership Council, *Submission 27*, p. 5.

3 The Australian Timeshare and Holiday Ownership Council (ATHOC) is 'a not-for-profit industry body whose membership categories represents all types of interests involved in the Australian timeshare industry', Australian Timeshare and Holiday Ownership Council, *Submission 27*, p. 1.

4 Australian Timeshare and Holiday Ownership Council, *Submission 27*, p. 5; Classic Holidays, *Submission 28*, p. 1; The Holiday Club, *Submission 38*, pp 1–2.

not precluded from the conflicted remuneration provisions 'there could be substantial and material negative impact on the timeshare industry and tourism in Australia'.[5]

7.4 Wyndham Vacation Resorts Asia Pacific seeks to have proposed section 963A within the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 amended to specifically clarify that timeshare payments are not conflicted remuneration.[6] Timeshare industry participants have supported this carve-out on the basis that a timeshare product differs from other financial products. Some of the key differences are that:

- Timeshare offers a lifestyle product and not a personal financial investment.[7]
- Timeshare representatives provide advice only in respect of a single timeshare product and do not provide any financial advice about other products. They do not provide advice about different ways of investing; only advice as it relates to purchasing the single timeshare product. Therefore, there is little likelihood for conflict or consumer confusion and resultant consumer harm.
- Holiday interests are not distributed through dealer groups or advisers, but are sold directly through sales offices, therefore, volume-based payments have no wider impact on competition in the financial planning industry.
- 'Holiday interests are in-house products and not provided by a financial product manufacturer',[8] and the situation is analogous to that of Authorised Deposit-taking Institutions (who have received a carve-out from the bans on conflicted remuneration).[9]

7.5 Diagram 7.1 outlines some of the key differences between timeshare sales representatives and financial services advisers.

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5 Gold Coast Tourism Corporation Ltd, *Submission 36*, p. 1; Queensland Tourism Industry Council, *Submission 43*, p. 2.

6 Wyndham Vacation Resorts Asia Pacific Pty Ltd, *Submission 30*, pp 10–11. The submission provides precise wording for the requested amendment for the Bill.

7 Mr Barry Robinson, Chairman, Australian Timeshare and Holiday Ownership Council, *Proof Committee Hansard*, 23 February 2012, p. 58.

8 Classic Holidays, *Submission 28*, p. 1.

9 Australian Timeshare and Holiday Ownership Council Ltd, *Submission 27*, p. 4.

Diagram 7.1: Comparison of timeshare sales representatives and financial advisers

Feature	Timeshare representative	Financial adviser
Australian Financial Service Licensee holder or representative	Yes	Yes
Receives commissions	Yes	Yes
Receives volume-based payments	Yes	Yes
Offers a financial return to investors	No	Yes
Offers a range of products with varying complexity	No	Yes
Offers products sourced from third-party providers	No (only in-house products)	Yes
Regulated as real estate in other jurisdictions*	Yes	No

Source: Committee secretariat, adapted from Wyndham Vacation Resorts Asia Pacific Pty Ltd, *Submission 30*; Australian Timeshare and Holiday Ownership Council, *Submission 27*.

* Including the United States and Canada. Source: Wyndham Vacation Resorts Asia Pacific Pty Ltd, *Submission 30*, p. 9.

7.6 Further, ATHOC emphasised that the four major timeshare companies that hold 90 per cent of the market 'have comprehensive disclosure and compliance programs and procedures to protect the consumer'.[10] Mr Barry Robinson, of ATHOC outlined that consumers are clearly informed before purchase that timeshare is not a financial investment and will not increase in value:

> In all of our disclosure documents and compliance plans it quite clearly states that this is not a 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.[11]

10 Mr Barry Robinson, Chairman, Australian Timeshare and Holiday Ownership Council, *Proof Committee Hansard*, 23 February 2012, p. 58.

11 Mr Barry Robinson, Chairman, Australian Timeshare and Holiday Ownership Council, *PJC Committee Hansard*, 24 January 2012, p. 34.

Committee view

7.7 The committee recognises that the bans on conflicted remuneration have unintentionally been applied to the timeshare industry. The committee acknowledges that timeshare is not offering a financial services product and recommends that the timeshare product be precluded from the bans on conflicted remuneration.

Recommendation 5

7.8 The committee recommends that the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be amended to preclude the timeshare product from the bans on conflicted remuneration.

Chapter 8

Asset-based fees on borrowed amounts

Introduction

8.1 This chapter looks at the provisions of the Corporations Amendment (Further Future of Financial Advice Measures) Bill (the Bill) that seek to place a ban on asset-based fees on borrowed amounts. This ban prohibits advisers from receiving a benefit based on a percentage of a client's borrowed funds under advice.[1] A 'borrowed amount' refers to an amount borrowed in any form, secured or unsecured.[2]

Reasons for the proposed amendment

8.2 The Parliamentary Joint Committee on Corporations and Financial Services' (PJC) 2009 inquiry into financial products and services received evidence that some advisers encourage consumers to gear their investment portfolios (use borrowed funds) to enable the adviser to increase the benefit of asset-based fees.[3] Evidence collected by the PJC indicated that in the collapse of Storm Financial some consumers had an insufficient understanding of the risk of borrowing against the equity of a family home.[4] Treasury outlined that the rationale for the measure 'is to prevent advisers from artificially inflating their advice fee by recommending a client borrow additional funds'.[5]

8.3 The Explanatory Memorandum to the Bill (the EM) outlined that advisers that are remunerated by the quantity of funds under management can have conflicts of interest:

> They have more of an interest in selling investment products to their clients and encouraging their clients to borrow to invest, or use other strategies to maximise funds under management (such as recommending that a client sell other assets, such as real estate and/or property, to invest in products that will expand available funds under management). The conflicts arise most notably where leverage is recommended or where leverage is included in the product.
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> ...

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1 Treasury, *PJC Submission 22*, p. 9.

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

3 Treasury, *PJC Submission 22*, p. 9; see also Joint Consumer Groups, *Supplementary Submission 41*, pp 9–10.

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

5 Treasury, *PJC Submission 22*, p. 9.

> Storm's remuneration model involved the use of asset based fees and commissions. For geared clients, Storm had a fee for service model (plus trail commissions) equating to roughly 7.5 per cent on all new money invested by clients. This covered the initial advice and ongoing regular servicing of the portfolio. Any additional money invested by the client also attracted this upfront fee for service. Also the product manufacturers would pay Storm annual trail commissions of between 0.2 per cent and 0.385 per cent on the value of that client's investment at the time (including the margin loan).
>
> Under the Storm model, the fact that fees were generated based on the amount of funds invested and the amount of funds under management created an inevitable conflict of interest between the adviser/licensee's interests in increasing revenue on the one hand and the interests of the client in receiving appropriate advice. Asset based fees create a conflict of interest that encourages advisers to recommend aggressive gearing to increase the upfront fee generated when the borrowed money is invested and to increase the balance of funds under management and thereby the ongoing fees generated. It also acts as a disincentive for advisers to build into the client's strategy an exit plan whereby investors can realise gains as a result of market increases to reduce overall debt, as this would reduce the fees earned by the adviser and licensee.[6]

Submitters' views

8.4 A number of submitters opposed the bans on asset-based fees.[7] The Financial Planning Association (FPA) submitted that asset-based fees 'are not a form of remuneration at all, but very simply a form of "calculating" remuneration'. It suggested that when utilised in combination with professional expectations and transparency, asset-based fees are not a conflicted form of remuneration.[8] Both the FPA and Burrell Stockbroking and Superannuation (BSS) suggested that the 'best interests duty' is sufficient to protect consumers in relation to gearing.[9]

8.5 BSS outlined that it takes a measured and conservative approach when advising a client to gear an investment portfolio. It argued that high-level, ongoing advice is required for consumers that have used borrowed funds to invest, and the ban on asset-based fees may decrease this sort of advice:

> 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

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6 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 49–50.

7 Financial Planning Association, *Submission 20*, pp 25–26; Burrell Stockbroking and Superannuation, *Submission 8*, p. 7; Mr Russel Tym, *PJC Submission 40*, p. 3.

8 Financial Planning Association, *Submission 20*, p. 25.

9 Financial Planning Association, *Submission 20*, pp 25–26; Burrell Stockbroking and Superannuation, *Submission 8*, p. 7.

> 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 led 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.[10]

8.6 Treasury argued, however, that ongoing advice and borrowing strategies for consumers can continue under the provision of the Bill where it is in the best interest of the consumer. Advisers will simply be required to use an alternative form of remuneration 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 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.[11]

Arguments that all forms of asset-based fees should be banned

8.7 The Industry Super Network (ISN) and the Joint Accounting Bodies (JAB) support the provision, and suggest that it should go even further and ban any form of asset-based fees, not just those on borrowed amounts. Further, ISN suggest that asset-based fees mimic the features of commission remuneration.[12] The Joint Consumer Groups (JCG) agreed and commented on some of these features:

> 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

10 Burrell Stockbroking and Superannuation, *Submission 8*, p. 7.

11 Treasury, *PJC Submission 22*, p. 9.

12 Industry Super Network, *Submission 5*, p. 2; Joint Accounting Bodies, *Submission 21*, p. 8.

> 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.[13]

8.8 Further to these concerns, JAB suggested that the proposed approach creates inconsistencies between the use of geared and un-geared investments and that this could create confusion for consumers:

> We believe permitting an asset based fee to be charged on the ‘ungeared’ component of a retail client’s funds will create confusion for the consumer, who may as a result of this policy decision be charged via multiple remuneration models. Further, it risks licensees and their representatives adjusting pricing structures so a nil fee or a very low fixed / flat fee may be payable on the geared component of the investment fund and a higher asset-based fee is charged on the ungeared component of the investment fund. The end result is that the payment is the same dollar value as would have previously been the case where an asset based fee is paid over the entire investment amount.
>
> Complex remuneration models may also lead to increased administration and compliance costs, which will inevitably result in the consumer having to pay a higher fee to access advice.
>
> Further, it may result in even more confusing and complex disclosure statements being provided to consumers should the annual disclosure statement and opt-in requirements be implemented.
>
> The Joint Accounting Bodies do not believe such outcomes would be in the public interest, nor would they remove complexity from the advice charging process. For this reason we recommend that asset based fees be banned where any component of the overall advice involves gearing.[14]

8.9 In addition, JCG highlighted that the regulation impact statement in the EM stated that '[g]iven the transition away from commission based arrangements, there is an expectation that advisers will more heavily rely on the use of asset based fees for remuneration'.[15]

Committee view

8.10 The committee acknowledges that advisers can use a fee for service model when advising clients to gear their portfolios rather than charging an asset-based fee. The committee sees the bans on asset-based fees on borrowed amounts as an

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13 Joint Consumer Groups, *Supplementary Submission 41*, pp 9–10.

14 Joint Accounting Bodies, *Submission 21*, p. 8.

15 Paragraph 3.37, *Explanatory Memorandum*, p. 49; see Joint Consumer Groups, *Supplementary Submission 41*, p. 10.

important and effective measure to remove the inherent conflict of interest associated with these fees. The ban provides essential consumer protection against aggressive gearing strategies recommended by advisers seeking only to increase the balance of funds under management and thereby the ongoing benefits generated.

8.11 The committee notes that the regulation impact statement in the EM foresees an increase in the use of asset-based fees (on non-borrowed amounts) as the industry moves away from other commission based models.

Recommendation 6

8.12 The committee recommends that the use of asset-based fees be closely monitored by the Australian Securities and Investments Commission (ASIC) post implementation of the Future of Financial Advice Bills. ASIC's findings should contribute to the proposed independent review of the Future of Financial Advice reforms (see recommendation 9).

Chapter 9

Soft-dollar benefits

Introduction

9.1 This chapter will look at proposed amendments to the 'soft-dollar', or non-monetary, benefits paid to a financial advisor. Soft-dollar benefits are 'any benefit received by a financial planning firm, its representatives or associates, other than basic monetary commissions or direct client advice fees'.[1] Soft-dollar benefits fall within the definition in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill) of conflicted remuneration that could 'reasonably be expected to influence financial product advice'.[2]

Proposed amendments

9.2 The Bill provides exceptions for the ban on conflicted remuneration for soft-dollar benefits including:

- 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;
- soft-dollar benefits that provide information technology software or support; and
- soft-dollar benefits in relation to execution-only (non-advice) services.[3]

9.3 The April 2011 Future of Financial Advice (FOFA) information pack noted that the initial announcement on the bans on conflicted remuneration did not include soft-dollar benefits. The financial advice advisory panel (see chapter 1) considered

1 Future of Financial Advice, Information Pack, 28 April 2011, p. 11, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 27 February 2012).

Taken from a broad definition of soft-dollar benefits as used in *ASIC Report 30 – Disclosure of soft dollar benefits* (June 2004), see http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/soft$_benefits_report.pdf/$file/soft$_benefits_report.pdf (accessed 27 February 2012).

2 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

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

soft-dollar benefits as part of its review of ethical standards and the 'deliberations of the panel have been a factor in the Government's decision to ban soft dollar benefits'.[4]

9.4 Further details of the bans on soft-dollar benefits relating to education, training and information technology are to be determined in the regulations to the Bill.[5]

Views of submitters

9.5 Submitters voiced concerns in relation to a number of elements of the exceptions on the soft-dollar bans. Some submitters believed some of the proposed exceptions were too stringent, others suggested that some elements should be more rigorous. Specifically, submitters raised the following issues:

- some legitimate forms of professional development will be banned;
- the exception for IT software or support is too broad, and should be limited specifically to product or platform specific support; and
- the domestic requirement for professional development and education.

Claims that legitimate forms of professional development will be banned

9.6 The Financial Planning Association of Australia (FPA), Westpac Group, the Australian Bankers Association (ABA) and the Financial Services Council (FSC) highlighted the uncertainty surrounding which educational and professional development benefits would be permitted under the FOFA reforms.[6]

9.7 Proposed subparagraph 963C(c)(ii) in the Bill outlines that a non-monetary benefit is not considered conflicted remuneration in certain circumstances including when 'the benefit is relevant to the provision of financial product advice'.

9.8 The ABA voiced concern that limiting professional development benefits to those that are relevant to 'financial product advice' may preclude other legitimate forms of training.[7] FSC, ABA, FPA and Westpac noted that there is a range of genuine professional development activities that are not directly relevant to 'financial

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4 Future of Financial Advice, Information Pack, 28 April 2011, pp 10–11, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 27 February 2012).

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

Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, proposed subparagraphs 963C(c)(iii) and 963C(d)(iii).

6 Westpac Group, *Submission 37*, p. 27; Financial Planning Association, *Submission 20*, p. 22; Australian Bankers' Association, *Submission 23*, p. 38; Financial Services Council, *Submission 18*, pp 82–83.

7 Australian Bankers' Association, *Submission 23*, p. 38.

product advice' including practice management, general economic information, client relationship skills, marketing, accounting, business strategy, and occupational health and safety.[8]

9.9 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'.[9]

9.10 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 suffice. FSC suggested that specific concerns on the various types of training should be addressed in regulations.[10]

9.11 Alternatively, FSC recommended that subparagraph 963C(c)(ii) be redrafted to read 'the benefit is relevant to the provision of financial services or to the conduct of a financial services business'.[11]

Claims that the bans on information technology are too broad

9.12 Proposed paragraph 963C(d) applies to non-monetary benefits in the form of IT support and software and, like the professional development provisions, it too has a relevance test.[12]

9.13 The Joint Consumer Groups (JCG) suggested the exception for IT software or support is too broad, and should be limited specifically to product or platform specific support, not just to that which is 'related to the provision of financial product advice' as stated in the Bill.[13] JCG submitted that the provision as currently drafted:

> ...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

8 Financial Services Council, *Submission 18*, pp 82–83; Westpac Group and BT Financial Group, *Submission 37*, p. 27; Financial Planning Association, *Submission 20*, p. 22; Australian Bankers' Association, *Submission 23*, p. 38.

9 The Westpac Group, *Submission 37*, p. 27.

10 Financial Services Council, *Submission 18*, pp 82–83.

11 Financial Services Council, *Submission 18*, pp 82–83.

12 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 30–31. The relevance test states that IT software of support will not be considered conflicted remuneration when 'the benefit is related to the provision of financial product advice to personas as retail clients in relation to the financial products issued or sold by the benefit provider'. See Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, subparagraph 963C(d)(ii).

13 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, amendment to subparagraph 963C(d)(ii) of the *Corporations Act 2001*.

> management and advice expert software like COIN which is not product or platform specific.[14]

9.14 The JCG have requested that the Bill be amended so that subparagraph 963C(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.' JCG suggested that, in addition, the Explanatory Memorandum to the Bill (EM):

> ...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.[15]

9.15 The April 2011 FOFA information pack provides some further detail on which forms of IT support and software will be banned. This is outlined in table 9.1.

Table 9.1: 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 Future of Financial Advice Information Pack, 28 April 2011, p. 11, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 29 February 2011).

9.16 The information pack also noted that '[f]urther details of the ban will be subject to implementation consultation, including the criteria for the exemptions for professional development and administrative IT services'.[16]

Committee view

9.17 The committee recognises that there is some uncertainty for members of the industry, and some consumer groups, in relation to the relevance tests for professional

14 Joint Consumer Groups, *Supplementary Submission 41*, p. 6.

15 Joint Consumer Groups, *Supplementary Submission 41*, p. 8.

16 Future of Financial Advice Information Pack, 28 April 2011, p. 11, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 29 February 2011).

development and IT support outlined in proposed subparagraphs 963C(c)(ii) and 963C(d)(ii) in the Bill.

9.18 The committee notes that the details of these provisions are still under consideration, and that further detail is to be provided in regulations for both professional development and IT support exceptions.[17] The committee also notes that some steps have been made to clarify the application of IT support in the April 2011 FOFA pack. The committee commends any measures taken to provide further clarity and certainty for both industry and consumer groups and considers further explanation on the application of the relevance test for professional development and IT support should be provided in the EM and regulations for the Bill.

Recommendation 7

9.19 The committee recommends that further material be provided in the Explanatory Memorandum and regulations 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; and**
- **specific examples of IT support and software that are banned, and not banned.**

Domestic requirement for professional development

9.20 As mentioned, the provisions pertaining to the exceptions to professional development benefits are still under consideration and further criteria will be specified in regulations. Proposed subparagraph 963C(c)(iii) states that genuine education and training will not be considered conflicted remuneration when 'the benefit complies with regulations made for the purposes of this subparagraph'.

9.21 The EM notes that while further consultation is envisioned, it is intended to prescribe the following obligations on the exceptions to professional development benefits in the regulations to the Bill:

- Domestic requirement — the professional development must be conducted in Australia or New Zealand.
- Majority time requirement — where 75 per cent of the time (during standard day of 8 hours or equivalent time) is spent on professional development. In a standard 8 hour day, this takes into account a one hour lunch break, as well as another hour that might be applied to other activities such as networking.

17 Proposed subparagraphs 963C(c)(iii) and 963C(d)(iii) state that a non-monetary benefit will not be considered conflicted remuneration when 'the benefit complies with regulations made for the purposes of this subparagraph'.

- Expenses — any travel costs, accommodation and entertainment outside of the professional development activity must be paid for by participants or its employer or licensee.[18]

9.22 On the whole submitters supported the criteria suggested, with the exception of the domestic requirement.[19]

9.23 Professional Investment Services argued that '[s]uch a prohibition will considerably restrict Australian financial services professionals' cross-jurisdictional education, and development as well as significantly hampering domestic innovation and development'.[20] In addition, IOOF Holdings noted that some larger licensees with overseas professional development commitments may have activities planned at least 18-24 months in advance.

9.24 These activities may involve contractual arrangements, and to withdraw from these may incur liabilities for licensees. Therefore, IOOF Holdings submitted that if the domestic requirement is passed by the Parliament, a minimum 2 year transition period should apply.[21]

Committee view

9.25 The committee recognises that a domestic requirement for exceptions to the bans on professional development benefits could hamper access to genuine education and training opportunities for licensees. The committee considers that this restriction should be removed, and the arguments presented to the committee should be considered in the development of the regulations pertaining to professional development.

Recommendation 8

9.26 The committee recommends that the regulations for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 should not place a domestic requirement on the conflicted remuneration exception provided on genuine education and training benefits. Paragraph 2.33 of the Explanatory Memorandum should be amended accordingly.

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

19 Australian Institute of Superannuation Trustees, *PJC Supplementary Submission 18*, p. 4; IOOF Holdings Limited, *PJC Submission 19*, p. 6; Financial Services Council, *Submission 18*, p. 83; Financial Planning Association, *Submission 20*, p. 23; Association of Financial Advisers Ltd, *Submission 31*, p. 15; Australian Bankers' Association, *Submission 23*, p. 39.

20 Professional Investment Services, *Supplementary Submission 17*, p. 14

21 IOOF Holdings Limited, *PJC Submission 19*, p. 7.

Scrutiny of Bills

9.27 The committee notes that the Senate Standing Committee for the Scrutiny of Bills has suggested that the Senate consider whether it is appropriate to delegate the detail of certain provisions relating to non-monetary benefits in regulations.[22]

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

Chapter 10

The Australian Securities and Investments Commission's new powers

10.1 This chapter will examine the proposed amendments to the *Corporations Act 2001* (the Act)[1] designed to clarify and enhance the powers of the Australian Securities and Investments Commission (ASIC) in relation to the issuing and control of Australian Financial Services Licences (AFSL).

10.2 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.[2] Currently, ASIC only has the ability to prosecute licensees: the Bill will allow ASIC to prosecute individual financial advisers in breach of their obligations.

10.3 The proposed changes to the Act 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. In highlighting the need for these changes, ASIC referred to the collapses of Storm Financial, Trio Capital and the Westpoint Group.[3]

10.4 Of particular concern to ASIC was the expectation gap that exists for some retail investors between what an AFSL represents and what it actually means. ASIC explained this in some detail:

> 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.[4]

10.5 The proposed enhancements to ASIC's powers were broadly accepted in evidence received by the committee.

Proposed amendments to ASIC's powers

10.6 Under the new provisions, ASIC's licensing and banning powers will be extended to allow it to:

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1 Unless otherwise stated, all section references are to the *(Cth) Corporations Act 2001*.

2 *(Cth) Corporations Act 2001*, Part 7.6.

3 Australian Securities and Investments Commission, *Submission 9*, p. 4.

4 Australian Securities and Investments Commission, *Submission 9*, p. 9.

- refuse to grant a licence or cancel or suspend an existing licence where ASIC has a reason to believe a person is likely to contravene (rather than will not comply with) their obligations under section 912A: amending paragraphs 913B(1)(b) and 915C(1)(aa) of the Act;
- ban a person (as opposed to an entity) who it has reason to believe is not of good fame or character or is not adequately trained or competent to provide financial services: paragraphs 920A(i)(d) and (da);
- ban a person (as opposed to an entity) where it has reason to believe the person is likely to contravene (rather than will not comply with) their obligations under section 912A: paragraph 920A(i)(ba);
- consider any conviction for an offence in the previous ten years involving dishonesty that is punishable by imprisonment for at least three months, when determining whether it has reason to believe a person is not of good fame or character: paragraph 913B(4)(a);
- ban a person if it believes they are likely to contravene (rather than will not comply with) a financial services law: paragraph 920A(1)(f); and
- ban a person who has been involved or it has reason to believe is involved, or is likely to be involved, in a contravention of obligations by another person: paragraph 920A(1)(g).[5]

10.7 In giving ASIC the power to ban a person on the basis that he or she is not of good fame or character, Bill 1 seeks to amend section 920A of the Act, to require ASIC to take into account:

> (a) any conviction of the person, within 10 years before that time, for an offence that involves dishonesty and is punishable by imprisonment for at least 3 months; and
>
> (b) whether the person has held an Australian financial services licence that was suspended or cancelled; and
>
> (c) whether a banning order or disqualification order under Division 8 has previously been made against the person; and
>
> (d) any other matter ASIC considers relevant: subsection 920A(1A).

10.8 The proposed new paragraph 920A(1)(g):

> ...enables ASIC to take into account conduct where the person is not under a legal responsibility to comply with the legislation themselves but they contributed or caused another person to breach the legislation.[6]

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5 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, pp 20–21.

6 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 25.

10.9 This provision is intended to apply where, as a director or employee of a licensed entity, the person was involved in a contravention of the Act. Section 79 of the Act states:

> A person is involved in a contravention if, and only if, the person:
>
> (a) has aided, abetted, counselled or procured the contravention; or
>
> (b) has induced, whether by threats or promises or otherwise, the contravention; or
>
> (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
>
> (d) has conspired with others to effect the contravention.

ASIC's current powers

10.10 ASIC, in their submission, set out the extent of their powers in relation to the granting and cancelling of AFSLs. Currently, ASIC must grant an AFSL if:

> (a) the application is made properly;
>
> (b) ASIC has no reason to believe that the applicant will not comply with the licensee obligations;
>
> (c) ASIC is satisfied that there is no reason to believe that the applicant or the applicant's responsible officers are not of good fame or character; and
>
> (d) the applicant has provided ASIC with any additional information requested for the purposes of assessing the application.[7]

10.11 Importantly, 'ASIC cannot refuse an application for an AFS licence for reasons beyond the [above] relevant criteria'.[8] Once the license is granted, there are constraints on ASIC's ability to suspend or cancel that license. Specifically:

> ASIC can only immediately suspend or cancel a licence on application by the licensee or where the licensee is insolvent, ceases to carry on the business, is convicted of serious fraud, or is incapacitated.[9]

10.12 The decision to cancel can only occur after a hearing when:

> (a) the licensee has not complied with its obligations;
>
> (b) ASIC has reason to believe the licensee will not comply with its obligations in the future;
>
> (c) ASIC is no longer satisfied that the licensee is of good fame or character;
>
> (d) a banning order is made against the licensee or a key representative of the licensee; or

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7 Australian Securities and Investments Commission, *Submission 9*, p. 7.

8 Australian Securities and Investments Commission, *Submission 9*, p. 7.

9 Australian Securities and Investments Commission, *Submission 9*, p. 7.

(e) the application was materially false or misleading or omitted a material matter.[10]

10.13 ASIC's position is that the current laws make it difficult to cancel a licence or refuse to grant one. Further, it argues that it has struggled to prove its case when its decisions have been appealed before the Administrative Appeals Tribunal and that this 'makes it difficult to remove licensees who may potentially cause investor losses in advance of an actual breach'.[11]

10.14 In addition, the licensing regime, as it stands presently, focuses on entities rather than their agents, such as employees or directors. This prohibits ASIC from restricting or banning an individual from providing financial services as the employee of a licensed body corporate.[12] On the whole, the Act relies on licensees to ensure the competency and integrity of its representatives in the industry.[13]

10.15 In their submission to the Parliamentary Joint Committee on Corporations and Financial Services (PJC), 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 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.[14]

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10 Australian Securities and Investments Commission, *Submission 9*, p. 7.

11 Australian Securities and Investments Commission, *Submission 9,* p. 7.

12 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, p.18; Australian Securities and Investments Commission, *Submission 9*, p. 6.

13 Australian Securities and Investments Commission, *Submission 9*, p. 8.

14 Treasury, *PJC Submission 22*, p. 8.

Submitters' views

10.16 Whilst the majority of submitters supported the proposed increase in powers for ASIC, there were also a number who requested more detail about how ASIC might implement them.

10.17 In a representative view, the Australian Institute of Superannuation Trustees (AIST) stated:

> 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.[15]

10.18 The Association of Superannuation Funds of Australia, in response to a question from Senator Cormann, stated that they 'support the new ASIC powers'.[16]

10.19 The Joint Consumer Groups made a similar unequivocal statement:

> The consumer representatives fully support the enhancements to ASIC's licensing and banning powers and have no comments on the drafting of the relevant provisions in the Bill.[17]

10.20 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, for example, commented:

> The Joint Accounting Bodies believe that if ASIC is to be provided additional powers as set out in the draft legislation, that serious consideration be given to ensure that there are rigorous rules around ASIC's use of such powers. While we appreciate the difficulty that ASIC has where it believes a person may breach their requirements and limitations of the current law, it is also important that procedural fairness is protected.
>
> Therefore, we are of the opinion that ASIC be required to set out in a practice statement how it intends to use the new powers. In particular, how ASIC will interpret '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.[18]

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15 Australian Institute of Superannuation Trustees, *Submission 35*, p. 7.

16 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 24 February 2012, p. 16.

17 Joint Consumer Groups, *Submission 41*, p. 15.

18 Joint Accounting Bodies, *Submission 21*, p. 5.

10.21 Similar positions were put by banking groups, such as the Australian Bankers' Association:

> The ABA broadly supports enhancing ASIC's powers to refuse and revoke licences and to ban individual advisers from the financial services industry. We welcome the clarifications made to the Bill in terms of "likely to contravene" and the Explanatory Memorandum in terms of the due diligence and evidentiary processes that would be undertaken by ASIC.
>
> However, we remain concerned about the breadth of the new measures and the application of administrative penalties to individuals and civil penalties to licensees or authorised representatives, and in particular in the absence of a reasonable steps defence.[19]

10.22 The Westpac Group also argued that more objectivity was required around how ASIC would wield its new powers, arguing that:

> [t]he Bill should be amended to include some objective criteria that ASIC would need to take into account when exercising its discretion to give, cancel, vary or suspend an AFSL such as:
>
> - the number of previous similar contraventions
> - the likelihood of a contravention remaining unrectified
> - the extent to which the likely contravention indicates the licensee or individual will not comply with their obligations in general.[20]

10.23 Whilst supporting ASIC's increased powers, the need for objective benchmarks was supported by the Association of Financial Planners:

> **CHAIR:** Did you have particular concerns concerning ASIC?
>
> **Mr Klipin:** I have no particular concerns in relation to ASIC, other than the clear need for the regulator to have very clear duties. I think that is to protect the regulator as well as to protect those that they are regulating. So, broader ASIC powers need some kind of, in our view, clear sense of what the benchmarks, what the criteria are.
>
> **CHAIR:** This is the argument about a clear framework for the application of rules and tests they bring to bear on your member associations?
>
> **Mr Klipin:** Correct.
>
> **Mr Anderson:** Where they view it is likely to breach, we are comfortable that there is a concept around that, but we would like clarity as to where that might be utilised and also some controls to make sure that it is not used inappropriately.[21]

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19 Australian Bankers' Association, *Submission 23*, p. 40.

20 The Westpac Group and BT Financial Group, *Submission 37*, p. 11.

21 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 50.

10.24 A slightly different position was put by the Stockbrokers Association of Australia. It agreed that more clarification was required in relation to ASIC's use of the new powers but was not optimistic that the new powers would be effective:

> The proposal will greatly broaden their powers, so there will need to be some clarity about when and how they are going to implement those powers. We made the point today that even though these powers look like they are going to be substantially increased, we doubt whether they are going to substantially increase powers to protect the public. That is why we have come up with our model, which we have been talking about for many years, about adopting the US style reporting mechanism, which will make sure that future employers know about misconduct when they are employing people who have worked elsewhere.[22]

Committee view

10.25 The committee understands the requests for greater objectivity about how the new rules will be applied. It is also aware however, that the uncertainty expressed by witnesses may be as much to do with broader apprehension over the suite of proposed changes than with the specifics of this particular element relating to ASIC's powers.

10.26 The committee draws attention to the extra clarification provided in the Explanatory Memorandum to the Bill (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.[23]

10.27 The committee also notes that the EM includes guidelines on the conduct ASIC may take into account in determining whether to ban individuals:

> - ASIC believes the individual has committed a fraud, but the individual has not been prosecuted or there is a delay or uncertainty in prosecution;
> - the individual has engaged in conduct causing serious detriment or financial loss to consumers, so that there is a need to protect the public;

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22 Mr Douglas Clark, Policy Executive, Stockbrokers Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 43.

23 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, pp 22–23.

- the individual has been subject to adverse findings in relevant criminal or civil proceedings, reflecting on their character;
- the individual has demonstrated a consistent failure to comply with the law, or with directions from any licensee or employer; or
- the individual has been a director or senior manager of a licensee that has had its licence suspended or cancelled.[24]

10.28 The committee is also reassured by the public utterances of ASIC that it would adopt a 'facilitative approach' to regulation of the reforms, and that it is already undertaking extensive consultation with the sector.

> I wanted briefly to take the opportunity to update this committee on some of the consultation that ASIC is undertaking on the implementation of the reforms. We have already announced that ASIC will be issuing regulatory guidance on the FoFA requirements, and obviously some of the drafting issues will affect the shape that regulatory guidance ultimately takes. This guidance will assist industry and for that matter other stakeholders to understand how we will administer the FoFA reforms, and in particular we have already announced that we plan on publishing guidance on the best interest duty, on scaled advice, on the ban of conflicted forms of remuneration and ASIC's amended licensing and banning powers. The development of this guidance will involve a consultative approach, which is consistent with ASIC's normal approach in relation to the implementation of law reform.[25]

10.29 And later:

> What we have indicated is that we would take a facilitative approach during the first year of the reforms to help that implementation take place in a measured and sensible way and we will be, as we always are, as consultative as possible within the timeframe that we are given around the sort of guidance that industry wants in this area.[26]

10.30 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.[27] The committee notes that the responsibilities of the PJC include ongoing oversight of ASIC and that the PJC has undertaken to 'closely monitor the

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24 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 25.

25 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 19.

26 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 19.

27 Australian Securities and Investments Commission, *Supplementary Submission 9*, p. 3; Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Parliamentary Joint Committee Hansard*, 24 January 2012, p. 73.

exercise of ASIC's new licensing and banning powers as conferred through the Future of Financial Advice legislation'.[28] The committee commends this commitment.

28 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 Report*, February 2012, p. 125.

Chapter 11

Impact on industry and implementation of the Bills

11.1 This chapter will look at the potential impact of the Future of Financial Advice (FOFA) reforms on the financial advice industry in relation to four areas:

- the impact on employment;
- the impact on advice;
- the cost to advisers of the 'opt-in' requirement; and
- the adequacy of the Regulation impact statements (RIS).

11.2 It will also consider issues surrounding the proposed implementation dates of the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the FOFA Bills).

Impact on employment

11.3 The impact of the FOFA reforms on the financial advice industry was the subject of heated discussion in the hearings held by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) in January 2012. By the time the Economics Committee held its hearings in February, much of the heat had been taken out of the issue as a result of a reduction in the projected job losses in the sector, as published in a January 2012 report by Rice Warner Actuaries.[1]

11.4 The Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Bill 2) referred to a March 2010 report from Rice Warner Actuaries which predicted adviser numbers, as a result of the FOFA reforms, would drop from 15,400 in 2010 to approximately 8,600 in 2024.[2] This report, prepared ahead of the final draft of the bills, assumed a ban on commissions for all retail risk insurance and a ban on all asset based fees. In Bill 2, the bans on risk insurance are limited to products within superannuation and the bans on asset-based fees are limited to borrowed amounts.

11.5 Rice Warner Actuaries updated their projections in January 2012. This more recent report estimates that, in relation to financial advisers:

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1 See Industry Super Network, *Submission 5, Supplementary Submission 1*, p. 8.

2 *Explanatory Memorandum*, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 44.

> ...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.[3]

11.6 That report went on to conclude that there will be a short-term boost to adviser numbers before 'setting toward a total level of employment broadly similar to the levels existing today'.[4]

11.7 Whilst there was some discussion in submissions (received prior to the January 2012 Rice Warner report) about the impact of the FOFA reforms on employment levels in the financial advice sector, there was very little discussion of the issue during the recent hearings held by this committee. Mr Richard Klipin, from the Association of Financial Advisers (AFA), argued that:

> The research that has been put out by Rice Warner on behalf of ISN—the first report is from March 2010—predicted a loss of over 6,800 advisers. The most recent report, from January 2012, has revised that and predicts the loss of 3,000 full-service advisers. So, either way, this legislation is going to see a significant reduction in the number of advisers, so the issue here is not whether there will be loss of jobs, but how many.[5]

11.8 Mr Klipin expanded on the AFA's concerns and explained they were less about the Rice Warner research itself and more focused on the fact that 'the government should have done this research and it should have been subject to independent testing and sensitivity analysis'.[6]

11.9 Mr Matthew Linden, Chief Policy Adviser of the Industry Super Network (ISN), the organisation which commissioned the Rice Warner research, argued that the report showed that the FOFA reforms would:

> ...allow adviser incomes to grow in real terms; and result in employment in the financial advice sector being broadly stable with opportunities for growth, depending on commercial strategies deployed.[7]

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3 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 8, attached to Industry Super Network, *Submission 5, Supplementary Submission 1*.

4 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 5, attached to Industry Super Network, *Submission 5, Supplementary Submission 1*.

5 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 49.

6 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, Thursday 23 February 2012, p. 49.

7 Mr Matthew Linden, Industry Super Network, *Proof Committee Hansard*, 23 February 2012, p. 16.

Committee view

11.10 The committee understands the concerns from some in the sector about the impact of the FOFA reforms on financial adviser numbers but is persuaded by the evidence it has received that there will be no significant negative effect.

The impact on advice

11.11 Linked to the broadly stable adviser numbers is the growth in the types of advice that will be provided under the FOFA reforms. The best estimates of the impact of the reforms on the delivery and nature of financial advice are again contained in the January 2012 Rice Warner report.

11.12 This report estimates that the FOFA reforms will lead to 1.77 million pieces of scaled and comprehensive financial advice being provided by 2025–26. This represents a doubling of advices if the FOFA reforms were not enacted.[8]

11.13 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 without the reforms.[9]

The cost of opt-in

11.14 In relation to the cost of the opt-in requirement, the Explanatory Memorandum notes that '[a]dvisers will also incur ongoing annual costs in that they must have clients opt-in each year to continue to provide ongoing service'.[10]

11.15 The projected cost of opt-in per client varies significantly depending on what is assumed advisers will be required to do. In a 29 August 2011 media release, the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, stated that ‘Rice Warner have estimated the cost of opt-in to be around $11 per client. This includes set-up costs and the cost of chasing up clients who are charged on-going fees but who advisers may not be in regular contact with'.[11]

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8 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 3, attached to Industry Super Network, *Submission 5, Supplementary Submission 1*.

9 Rice Warner Actuaries, 'The Financial Advice Industry post-FOFA', January 2012, p. 3, attached to Industry Super Network, *Submission 5, Supplementary Submission 1*.

10 *Explanatory Memorandum*, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 61.

11 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *Media Release No. 127*, 29 August 2011, http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/127.htm&pageID=003&min=brsa&Year=&DocType=0 (accessed 29 February 2012)

11.16 The Financial Planning Association's (FPA) estimate, based on an independent survey of advisers, was $133 per client;[12] Burrell Stockbroking and Superannuation's estimate was five times this amount at 'around $650' per client.[13]

11.17 The committee focused on the cost and potential administrative burden of opt-in arrangements for sector representatives. Mr Douglas Latto, of the Corporate Superannuation Specialist Alliance (CSSA), was asked if his organisation had done any sort of costing of the opt-in requirement:

> Not a precise cost. I have hundreds of people to whom this would apply if they had the retrospectivity, as well, of the renewal notice. That retrospectivity would cost us a lot of money. We each would have hundreds and hundreds of clients we would have to write to. It is not just the fact that you have to tell them what their fee is. If it was just that then maybe the 11 recommendations might be somewhere near the mark, but we have to tell them what our services are, we have to tell them what our services are going to be next year. Each one could be different for each person.[14]

11.18 Dr Deen Sanders of the FPA had broader concerns about the opt-in requirement:

> As well as additional costs, it may even increase liability in terms of the exposure to client detriment. We are uncertain how it will play out that, where a client fails to opt in, as to what consequences and liability attaches to the client for failed portfolios or the adviser for impacts on portfolios.[15]

11.19 There was however, some evidence presented in opposition to the above estimates. Mr Linden of the ISN countered the assertion that the opt-in requirement would add much in terms of administrative burden:

> Others have said opt-in is a red tape nightmare, but surely, how hard is it for a planner to seek consent for an ongoing fee arrangement every two years if they are indeed providing ongoing advice and at least meeting with them that regularly.[16]

11.20 Associate Professor Joanna Bird speaking on behalf of the Joint Consumer Groups put the issue of the cost of the opt-in provision slightly differently by arguing that there was a clear cost to clients paying ongoing fees for services they were not

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12 Financial Planning Association, *Submission 20*, p. 8.

13 Burrell Stockbroking and Superannuation, *Submission 8*, p. 3.

14 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 12.

15 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 38.

16 Mr Matthew Linden, Chief Policy Adviser, Industry Super Network, *Proof Committee Hansard*, 23 February 2012, p. 16.

receiving and that financial advisers had a choice about the type of service they want to provide:

> Do not forget that this does not apply to every adviser. This only applies to those advisers that have chosen to enter into ongoing relationships with their clients. If you were an adviser and you hate this you could choose to run a business that never came near this.[17]

11.21 The issue of the cost of opt-in was also raised with Mr Jim Murphy of the Treasury:

> **Senator CORMANN:** Have you done a cost-benefit analysis on that aspect of the FoFA changes?
>
> **Mr Murphy:** Yes.
>
> **Senator CORMANN:** Can you release the cost-benefit analysis?
>
> **Mr Murphy:** Hopefully. I would very much like it to be released, but it is a matter for the government.[18]

Committee view

11.22 The committee is not convinced that the opt-in requirements will add a significant administrative burden to a financial adviser already in regular contact with a client. The committee does, however, agree that in the interest of transparency, it would be helpful if the government could release the cost-benefit analysis, including those elements included in coming to a conclusion about the final cost.

Regulation impact statements

11.23 The Explanatory Memoranda to the FOFA Bills each contain a Regulation impact statement (RIS). They acknowledge at the outset that the RIS is based on the policies announced by the government in April 2010.

11.24 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.[19]

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17 Associate Professor Joanna Bird, University of Sydney, on behalf of Joint Consumer Groups, *Proof Committee Hansard*, 23 February 2012, p. 57.

18 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 23 February 2012, p. 29.

19 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).

11.25 In evidence to the PJC, Treasury acknowledged that time was a key factor in the OBPR's finding that the RISs were inadequate. Mr Jim Murphy of 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.[20]

11.26 Mr Murphy explained 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'.[21]

11.27 Subsequently, at the hearing held by the Economics Committee on 23 February 2012, Mr Murphy, was able to provide some more information:

> **Senator CORMANN:** I am sure my first question is not entirely unexpected, but given that Treasury's draft regulatory impact statements in relation to FoFA across six out of seven areas failed to meet the government's own best practice regulation requirements, the Office of Best Practice Regulation having found that they were not adequate, is there any move within government to review the draft regulatory impact statements to bring them up to a standard where they would comply with the government's own best practice regulation requirements?
>
> **Mr Murphy:** I think the best answer to that is that the minister is considering that.[22]

11.28 The absence of valid RISs drew criticism from a number of witnesses. Mr Dante De Gori, of the FPA, submitted that:

> ...there has been no appropriate regulatory impact analysis conducted by Treasury on the cost implications of these reforms to industry and, more importantly, to consumers and that this has been a fundamental flaw in the process.[23]

11.29 He reiterated this point later in the hearing:

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20 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury *PJC Committee Hansard*, 24 January 2012, p. 60.

21 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury *PJC Committee Hansard*, 24 January 2012, p. 60.

22 Mr Jim Murphy, Executive Director, Markets Group, Department of the Treasury, *Proof Committee Hansard*, 23 February 2012, p. 26.

23 Mr Dante de Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 32.

> Though there have been a number of figures bandied about in respect of costs, associated job losses and so on, until you have what we believe to be an independent assessment, a regulatory impact statement from government, this argument will continue.[24]

11.30 Mr Hugh Elvy, representing the Joint Accounting Bodies, made a similar point when asked if he felt a thorough regulatory impact assessment should be conducted:

> Yes, absolutely. There should be a regulatory impact statement and so forth. An assessment should be done.[25]

11.31 Mr Klipin asserted that one of the conditions for the support of the AFA for the FOFA reforms was that:

> ...a complete and proper regulatory impact statement takes place. So, all of the issues that we are talking about, needing modelling, unintended consequences and so on, are absolutely mapped out, so we can all go into this with our eyes wide open.[26]

Committee view

11.32 The committee recognises that the lack of a clear cost-benefit analysis and relevant RISs has hindered but not prevented debate about the FOFA reforms and their impact. It is the committee's view that, in the interest of widening understanding of the impact of the reforms, that the cost-benefit analysis and RISs should be released by the government at the earliest opportunity. In its evidence to this committee, Treasury indicated that this was its preferred option.

Commencement date of the reforms

11.33 The commencement date of the FOFA reforms is 1 July 2012. There was considerable debate amongst witnesses about the practicality of such a date. The majority of evidence put to the committee was that the reforms could not be implemented in such a short space of time.

11.34 Those supporting the implementation date argued that to delay any longer would mean recipients of financial advice would continue to pay for services they were not receiving or to pay for advice that did not transparently declare conflicts of interest.

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24 Mr Dante de Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 38.

25 Mr Hugh Elvy, Head, Financial Planning, Institute of Chartered Accountants, *Proof Committee Hansard*, 23 February 2012, p. 45.

26 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 49.

11.35 There were many voices advocating a delay in implementation of the bills.

11.36 Mr Douglas Latto of the CSSA opposed a 1 July 2012 start date, arguing instead that the FOFA reforms should start at the same time as the MySuper reforms on 1 July 2013:

> I must mention at this point that we do understand the committee is focused on FoFA reforms. The MySuper reforms are so inextricably linked to FoFA that at times our issues will cross over between the two. I ask for your understanding if we also therefore mention some issues that relate to MySuper.
>
> We do firmly believe that the two pieces of legislation should be viewed and implemented together. We do not believe that 1 July 2012 is a realistic start date for FoFA.[27]

11.37 The Stockbrokers Association of Australia also opposed the proposed start date:

> We believe the timetable for implementation of the new measures is very short. If the new measures are to come into effect on 1 July 2012, as the government has announced, especially given the current parliamentary inquiries and lack of details of the requirements, members will not have enough time to make systems, policy and procedural changes that will be necessary for the implementation. This is particularly the case where the requirements are to be set out in regulations, which is the case with the stockbrokers carve-outs. We therefore seek a further transition period of at least 12 to 18 months from 1 July 2012 until the end of 2013.[28]

11.38 Similarly, the Joint Accounting Bodies proposed a one year delay for the same reasons:

> Given the uncertainty over some of the elements of the opt-in provisions, we would recommend a commencement date of 1 July 2013. Not only will this provide the industry and regulator with further time to ensure effective transition so FoFA can meet its policy objectives, it will align with the reforms under the stronger super, which will help reduce costs of implementation of the reforms for the industry.[29]

11.39 The FPA was in agreement with this proposal:

> In consideration of where we are at in the stage of the reform process and legislative process, and considering the multiple amounts of reform changes

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27 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard*, 23 February 2012, p. 7.

28 Mr David Horsefield, Chief Executive Officer, Stockbrokers Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 40.

29 Mr Hugh Elvy, Head, Financial Planning, Institute of Chartered Accountants, *Proof Committee Hansard*, 23 February 2012, p. 46.

required, we think that a transitional period or aligning it with MySuper 1 July 2013 would be appropriate. We would support that.[30]

11.40 Mr John Brogden of the Financial Services Council made the most vehement call for a delayed start date when he said:

> Our concern is this: if we do not know what this legislation looks like until April, May; we have got to start by 1 July this year. I must make it as clear as I possibly can, we simply will not be able to comply. It is beyond the point where we can comply. Not simply on the cost of complying, not simply on the IT systems, which our members tell us that we really have six and eight month lead-up times to get them developed and test them, but just training staff on how best interest duty works. We just make an absolutely impassioned plea that this committee recognise and recommend that the implementation date commence on 1 July 2012 but be phased in over a 12-month period. We simply cannot do it by 1 July this year. That is number one. Number two is if we are looking for comparisons, I remind you that the financial services regulation regime had a two-year phase-in. We are desperate that this be acknowledged and be dealt with publicly as quickly as possible.[31]

11.41 Perhaps the most nuanced position was put by Ms Pauline Vamos of the Association of Superannuation Funds of Australia. She acknowledged the complexity of the reforms and suggested a range of options around implementation:

> We have a number of options. We can start on 1 July 2012 and ASIC can take a soft enforcement approach over one or two years. We can delay the whole lot for a year. We can start some obligations, like the best interest duty, on 1 July 2012 and others that require substantial system changes on 1 July 2013. Or we have a hard start on 1 July 2012, with a two-year transition. The list can go on. There are a number of options. What we suggest to the committee is that the recommendations be open to a number of options.[32]

11.42 The Australian Securities and Investments Commission (ASIC) has indicated in their public comments some support for a transitional start to the FOFA reforms, saying that:

> We have indicated is that we would take a facilitative approach during the first year of the reforms to help that implementation take place in a measured and sensible way and we will be, as we always are, as

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30 Mr Dante de Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard*, 23 February 2012, p. 39.

31 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 7.

32 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 24 February 2012, p. 14.

> consultative as possible within the timeframe that we are given around the sort of guidance that industry wants in this area.[33]

11.43 A similar staged approach was advocated by ANZ Wealth in its submission to the committee. Arguing for the need to align compliance relationships between the FOFA Bills and the MySuper legislation, and citing the long consultation process, ANZ Wealth provided a detailed 'transition pathway'.[34] It suggested the majority of FOFA provisions should commence on 1 July 2012 and other elements considered more contentious and onerous to implement, such as the annual fee disclosure requirements and opt-in provisions, could be delayed.

Committee view

11.44 The committee understands that there is a good deal of legitimate concern about the proposed implementation date for the FOFA reforms but also acknowledges that most elements of these reforms have been in the pipeline and widely known for a number of years.

11.45 The committee also understands that there have been announcements from the office of the Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, that consideration is being given to extending the implementation date and that an announcement would be made in early 2012. At the time of writing, no announcement had been made.

11.46 Whilst the committee would prefer that the reforms be implemented as early as possible, they consider that it is not unreasonable for institutions facing substantial system changes to be given some leeway in implementing the reforms and that the 'facilitative approach' proposed by ASIC would be appropriate in the first year of operation.

Concluding comments and recommendations

11.47 The FOFA Bills implements significant and vital reforms to the financial advice industry to ensure that consumers are provided with transparent advice that is in their best interests.

11.48 The evidence collected by the 2009 PJC inquiry into financial products and services vividly exposed the need for these substantial reforms and for more effective regulatory enforcement of the industry.

11.49 The PJC inquiry was conducted in the wake of the collapse of a string of high profile financial product and service providers, including Storm Financial and Opes Prime. Evidence to the inquiry revealed that many advisers were offering advice

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33 Mr Peter Kell, Commissioner, Australian Securities and Investments Commission, *Proof Committee Hansard*, 24 February 2012, p. 21.

34 ANZ Wealth, *Submission 40*, p. 5.

supported by modes of conflicted remuneration which did not consider the interest of the client as paramount. This resulted in severe detriment to consumers.

11.50 Evidence to the inquiry also noted the origins of the financial advice industry, where advisers acted as sales staff representing financial product manufacturers. It highlighted that contemporary consumer expectation that financial advisers will provide unbiased advice in the interest of the client do not align with these origins and currently many advisers tend to play a dual role of providing advice as well as acting as sales representatives for financial product manufacturers.

11.51 Current remuneration models in the industry such as commissions, trail commissions, volume bonuses and shelf-space fees create entrenched conflicts that advisers must manage when providing advice to consumers. In addition, under current regulation, advisers may artificially inflate the asset-based fee they will receive by encouraging consumers to use borrowed amounts to increase their investments.

11.52 The committee notes that the distinguishing feature of commissions is that they are built into the fees paid by the client to acquire or hold the product and that following the investment, the consumer cannot control the commission. This translates into clouded fee arrangements that are bundled into the overall fees for financial products leaving consumers unaware of the full cost of the advice they receive.[35]

11.53 The combination of the opt-in and annual fee disclosure statement provisions will expose hidden on-going fees and trail commissions, ensuring consumers are engaged and informed of an on-going relationship with an adviser and its related fees. The best interests obligation further enhances consumer protection and the professionalism of the industry, as do the bans on conflicted remuneration and the additional responsibilities given to ASIC.

11.54 The committee does acknowledge the concerns of the industry given these far-reaching reforms. The committee believes that the vast majority of these concerns will be allayed through the release of the draft regulations to the FOFA Bills and the additional regulatory guidance that ASIC has undertaken to provide. However, the committee recognises that the industry will be required to make substantial adjustments to apply the proposed reforms, and the transition period should be monitored accordingly.

11.55 The committee, therefore, recommends that a holistic independent review of the future of financial advice reforms be undertaken. The review should provide reports at 12 and 24 month intervals post implementation of the FOFA Bills. As discussed earlier in this report (see chapters 5 and 8), the review should include consideration of the sale of insurance inside and outside superannuation as well as the use of asset-based fees on non-borrowed amounts.

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35 Australian Securities and Investments Commission, *Supplementary Submission 9*, p. 13.

Recommendation 9

11.56 The committee recommends that independent reviews of the Future of Financial Advice reforms are conducted in 12 and 24 month intervals following the commencement of the FOFA Bills. The reviews should consider the measures taken by the Australian Securities and Investments Commission in response to the new measures as well as industry's compliance with the provisions of the FOFA Bills.

Recommendation 10

11.57 The committee recommends that, subject to the above recommendations, the FOFA Bills should be passed.

Senator Mark Bishop
Chair

Dissenting Report by Coalition Senators

FOFA bills need important improvements

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

1.2 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.

1.3 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.

1.4 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.

1.5 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.

1.6 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.

1.7 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.

1.8 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.

1.9 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.

1.10 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.

1.11 One of the key observations of the Ripoll Inquiry in 2009, which Coalition Senators 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.

1.12 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.

1.13 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, without proper appreciation or assessment of the costs involved, of any unintended consequences or other implications right up until the introduction of the current legislation.

1.14 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.

1.15 It is the view of Coalition Senators 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; and

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)

- Likely to cost about $700 million to implement and a further $350 million per annum to comply with, according to conservative industry estimates.

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

1.17 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 Senators assert that such an adequate regulatory impact assessment is necessary to properly assess the impact of FOFA on businesses, consumers and the wider economy.

1.18 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.

1.19 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).

1.20 In this context it is important to note that only one submission to the original Ripoll Inquiry (out of a total of 407 submissions) argued in favour of Opt-In and that was the submission from the Industry Super Network.[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.

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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)

1.21 Coalition Senators recommend that the Senate insist on a proper and Regulatory Impact Statement. That is a Regulatory Impact Statement which complies with the government's own best practice regulation requirements and is found and certified to be adequate and compliant with those requirements by the government's own Office of Best Practice Regulation.

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

1.23 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.

1.24 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 Senators 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.

1.25 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.

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

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

1.28 Coalition Senators highlight the following specific concerns with the legislation and urge all Senators to carefully consider these concerns before voting on the legislation.

Impact of FOFA on the financial advice industry

1.29 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.

1.30 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]

1.31 Comments from Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers also addressed the impact of the additional costs of this legislation on the financial planning industry as well as highlighted the lack of process and unrealistic implementation time frames:

> In our view, there has been a complete lack of process leading to substantive policy change without notice, without research or modelling. For example, the retrospective annual fee disclosure statements, the life insurance commission bans, in and then only out of super, the opaque and vague nature of the drafting of the legislation in a number of areas, the lack of understanding of the nature of property rights of advisers, the significant costs to comply as stated by the FSC, $700 million to implement and $350 million per annum for no benefit to consumers, and of course, the rapid industry consolidation that we have seen, in part driven by the business threats to FoFA, and of course, the need for a completely realistic timetable to implement effectively.[5]

1.32 Mr Klipin also highlighted the potential job losses in the industry if the legislation was introduced in its current form:

> Our intent is not to criticise the Rice Warner report, but more importantly to focus on the fact that the government should have done this research and it should have been subject to independent testing and sensitivity analysis. The AFA believes that there will be job losses and they will be greater than 3,000 jobs, so have great concerns. So, in conclusion, FoFA as it stands, will create a number of jobs lost in the industry; whether you use 6,800 or 3,000, there is a significant number. There will be significant impacts for the businesses that they support, the communities that they nurture and the clients they service. Any piece of legislation that inflicts this amount of damage is unacceptable.[6]

1.33 Coalition Senators 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

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4 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 7.

5 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard,* 23 February 2012, p. 48.

6 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard,* 23 February 2012, p. 49.

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

1.34 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.

1.35 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 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.[7] The government's erratic development of, and constant changes to, the FOFA reforms are partly responsible for this significant defect.

1.36 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'.

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7 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).

> 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?
>
> Mr McNamara: There was: the carve out of simple products; treatment of soft dollar benefits; access to advice; replacement of the accountant's exemption; renewal requirements on ongoing financial advice fees to retail clients; and the treatment of paid commissions on insurance products within superannuation and life insurance products outside of superannuation.
>
> Senator CORMANN: In all of these things the government did not have adequate information in front of it as far as the regulatory impact statement is concerned before it made—
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> …
>
> Mr McNamara: There is a draft RIS on those elements. Treasury had prepared RISs on those elements. From our point of view they were not yet adequate.[8]

1.37 The Financial Planning Association stressed to the Committee the need for a full and compliant Regulatory Impact Statement to enable the proper assessment of the full impact of the legislation:

> Mr De Gori: Yes. Though there have been a number of figures bandied out in respect of costs, associated job losses and so on, until you have what we believe to be an independent assessment, a regulatory impact statement from government, this argument will continue.
>
> Senator CORMANN: It should be to a standard that at least complies with the government’s own best practice regulation requirements as per their own Office of Best Practice Regulation, right?
>
> Dr Sanders: At least, I would suggest that. In fact, part of the challenge for this debate—and we certainly heard Treasury’s concerns and support them—is that this is a difficult area to calculate, given the complexity. We are talking about the projection of future national savings pools based on 10c and 15c removal or something from a process. It is an enormously complex area of activity. We think, in fact, that measuring value, measuring cost benefit when you are talking about things like job losses is fairly

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

> obvious, but measuring the potential national savings pool benefits or the retirement policy income benefits are significantly complex policy settings. We would be concerned that a cursory analysis of individual components does not do the deed here. This is a much more considered strategic cost impact that needs to be worked through.[9]

1.38 Coalition Senators 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.

1.39 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[10] and the significant job losses outlined above.

1.40 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.

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

Recommendation 1

1.42 That the Senate 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

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

1.44 Various organisations stated clearly to the Committee that this time frame was unrealistic and needed to be altered. They also stated a strong preference to align the commencement date of FOFA with the commencement date of the proposed MySuper changes.

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9 *Proof Committee Hansard,* 23 February 2012, pp 38–39.

10 Mr John Brogden, Chief Executive Officer, Financial Services Council, *Proof Committee Hansard*, 24 February 2012, p. 7.

1.45 The Corporate Superannuation Specialist Alliance stated as follows:

> Senator CORMANN: And just finally—and we have discussed this before—your view is that the implementation timetable between the FoFA changes and the MySuper changes should be aligned? We are getting quite close to the 1 July 2012 deadline, so you think 1 July 2013 would be a better one?
>
> Mr Latto: Yes, either July or October 2013 when MySuper has to come in.[11]

1.46 The Financial Planning Association also expressed their concerns about the proposed start date:

> Senator CORMANN: I have a question on the timetable. I assume you agree that the 1 July 2012 timetable is not realistic and that there should be an alignment between the FoFA and MySuper timetables and a deferral of implementation to some time after 1 July 2013?
>
> Mr De Gori: In consideration of where we are at in the stage of the reform process and legislative process, and considering the multiple amounts of reform changes required, we think that a transitional period or aligning it with MySuper 1 July 2013 would be appropriate. We would support that.
>
> Dr Sanders: Noting that our own commission banning remuneration policy has effect and will continue to work through the marketplace, we think that an extra 12 months for industry's understanding of the way these things work together would be an effective timeframe.[12]

1.47 Mr Hugh Elvy, Head of Financial Planning, Institute of Chartered Accountants, representing the Joint Accounting Bodies: stated a clear preference for a 1 July 2013 start date:

> Given the uncertainty over some of the elements of the opt-in provisions, we would recommend a commencement date of 1 July 2013. Not only will this provide the industry and regulator with further time to ensure effective transition so FoFA can meet its policy objectives, it will align with the reforms under the stronger super, which will help reduce costs of implementation of the reforms for the industry.[13]

1.48 Coalition Senators 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.

1.49 Coalition Senators also consider that it would make sense to implement FOFA and MySuper simultaneously. These two major changes require significant changes to

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11 *Proof Committee Hansard*, 23 February 2012, p. 12.

12 *Proof Committee Hansard,* 23 February 2012, p. 39.

13 Mr Hugh Elvy, Head of Financial Planning, Institute of Chartered Accountants, representing the Joint Accounting Bodies, *Proof Committee Hansard,* 23 February 2012, p. 46.

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

1.50 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

1.51 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.

1.52 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.

1.53 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.

1.54 The Financial Planning Association outlined to the committee that as a profession community, 'we have already banned commissions'. The FPA questioned whether addressing conflicted remuneration through statutory measures, such as the opt-in provisions, was appropriate:

> Our view, far more fundamentally, is that you negotiate and improve on those behaviours through professional engagement, through the establishment of professional rules and expectations, which is a piece of the puzzle that we think has been left bare in the FoFA debate, and it is something that we think can be addressed quite easily.[14]

14 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association of Australia, *Proof Committee Hansard,* 23 February 2012, p. 34.

1.55 The Corporate Superannuation Specialist Alliance expressed their concerns about these proposals and highlighted that they would lead to less transparency and reduce choice for consumers:

> Mr Hall: We are also opposed to opt-in and to the compulsory provision of renewal notices by advisers. The cost to our members will be significant. This information is already provided by the administrators of the superannuation fund, so another notice will only be confusing to consumers.
>
> If advice firms such as the CSSA member firms are forced out of the market, consumers will have no choice but to deal directly with product providers. Product providers will not have as much pressure to reduce their fees and in fact their fees may increase as they will have to pay salaries to more people who are employed to do the work that we currently do.
>
> Consumers will find it much more difficult to receive unbiased advice as it is unlikely that, for example, an employee of one bank will recommend the product of another bank. It is also unlikely that they will reduce their costs if they do not have to and, if the industry becomes more consolidated, the small number of remaining players will be under less pressure to be competitive. The employees are simply paid salary and bonuses from administration fees rather than commission or adviser fees, so what is the difference in reality? We feel it is less transparency, rather than more.
>
> Consumers will have to opt in to paying the ongoing asset based fees of the product manufacturers. They will not have to opt in, they just pay them regardless. Their only choice will be to move to another product provider or to a self-managed fund.[15]

1.56 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.[16]

1.57 The Coalition Senators strongly oppose Labor's push to force people to re-sign contracts with their advisers on a regular basis.

1.58 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.

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15 Mr Gareth Hall, Board Member and Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard,* 23 February 2012, p. 10.

16 Professional Investment Services, *Submission 17*, p. 3, 5.

1.59 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.

1.60 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.[17]

1.61 Coalition Senators 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.

Recommendation 3

1.62 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

1.63 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.

1.64 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.

1.65 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

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17 Financial Planning Association of Australia Limited, *Submission 20*, p. 7.

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.

1.66 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:

> Dr De Gori: Although the FPA acknowledges our significant involvement in the consultation process, in particular the numerous consultation meetings and discussions hosted by Treasury with the peak consultation group, as well as individually with the minister's office, for which we are very appreciative, the process of the reform agenda has been lengthy and disjointed, especially with respect to how and why certain decisions were made. For example, the decision to amend the fee disclosure statement from originally only applying to new clients in the draft legislation, to then applying to all clients in the current legislation, is a clear case in point. Similarly, the expansion of opt-in from within the MySuper framework and extending it to all financial advice is another example.[18]

1.67 The AFA also expressed its surprise that after considerable consultation, the final version of the Bills contained a retrospective element that had never been part of the issues being discussed in the consultation process:

> Mr Anderson: We only have to have a look at the first draft that came out in August or September that did not include that retrospective element to it. The entire industry got particularly surprised on 13 October when the draft was read to the house and was made available. That was absolutely unexpected and there was a lot of discussion around the industry as to this significant surprise that came in that. The implications of that change are huge in terms of legacy systems and legacy clients. The work that would be required to respond to that has more than doubled the whole project involved.[19]

1.68 In relation to the retrospectivity of the proposed fee disclosure statements, AMP pointed out in its submission to the Parliamentary Joint Committee on Corporations and Financial Services, which also inquired into these Bills, 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.[20]

1.69 In their submission to the PJC, AMP 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

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18 Dr Dante De Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard,* 23 February 2012, p. 33.

19 Mr Philip Paul Anderson, Chief Operating Officer, Association of Financial Advisers, *Proof Committee Hansard*, 23 February 2012, p. 51.

20 AMP Financial Services, *Submission 43* to the Parliamentary Joint Committee on Corporations and Financial Services, p. 12.

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 ongoing advice would also contain the statement that a client is able to cease making these payments at any stage.[21]

1.70 In the submission to the PJC, 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.

21 AMP Financial Services, *Submission 43* to the Parliamentary Joint Committee on Corporations and Financial Services, p. 12.

> 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.[22]

1.71 Coalition Senators 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.

1.72 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.

1.73 Coalition Senators 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.

1.74 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

1.75 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.

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22 AMP Financial Services, *Submission 43* to the Parliamentary Joint Committee on Corporations and Financial Services, p.13.

Recommendation 5

1.76 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

1.77 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.

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

1.79 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.

1.80 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.

1.81 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.[23]
>
> ...
>
> 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.[24]

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23 The Trust Company, *Submission 14*, p. 11.

24 The Trust Company, *Submission 14*, p. 7.

1.82 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.[25] (emphasis added)

1.83 Many stakeholders argued against the inclusion of the 'catch-all' provision in 961B(2)(g), including the FPA which stated as follows:

> Dr Sanders: Firstly, our position has always been one of supporting best interest. It is a fundamental principle of our professional obligations with the client. It is a first principle. The concern with the way it is couched in the current bill is that an interpretation that is absolutely available is that it is a disincentive to scalable advice, and that in particular 961B(2)(g)—and I think that has been referenced already in some of the evidence provided this morning—imports an obligation to know all of the things about a client to be able to act in their best interest. Whilst we support the fundamental principle of that, we think it is a challenging expectation. We understand that other industry members have taken an interpretation that that is too large an ask, that it is a disincentive to cost. I think you have referenced already the FSC's proposal that they see that as an impediment to scalable advice.[26]

1.84 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.[27]

1.85 Coalition Senators 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.

1.86 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

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25 Financial Services Council, *Submission 18*, p. 42.

26 Dr Deen Sanders, Chief Professional Officer, Financial Planning Association of Australia, *Proof Committee Hansard*, p. 32.

27 Financial Services Council, *Submission 18*, p. 41.

legislation subject to potentially protracted legal arguments. We therefore recommend that this clause be removed from the Best Interests Duty.

Recommendation 6

1.87 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

1.88 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.

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

1.90 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.[28]

1.91 Several organisations argued that the wording in subsection 961B(2) should be amended to explicitly allow the provision of scaled advice.[29]

1.92 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.[30]

1.93 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

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28 Association of Financial Advisers Ltd, *Submission 31*, p. 12; Westpac Group and BT Group, *Submission 37*, p. 15; Professional Investment Services, *Supplementary submission 17*, pp 5–6.

29 Financial Services Council, *Submission 18*, p. 46;
Australian Bankers' Association, *Submission 23*, p. 17.

30 Financial Services Council, *Submission 18*, p. 45.

agreement with the adviser, will scalable and affordable advice be delivered by these reforms.

1.94 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.

1.95 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.

1.96 Coalition Senators 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 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.

1.97 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

1.98 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

1.99 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.

1.100 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.

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

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

1.103 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.[31]

1.104 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.

1.105 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.

1.106 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.

1.107 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.

1.108 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.

1.109 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.

1.110 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.

1.111 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.

1.112 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.

1.113 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

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

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.

1.114 The AFA clearly expressed the concerns of the industry and 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.[32]

1.115 The Financial Planning Association of Australia requested an amendment to the definition of 'group life' within super to allow for commissions to be payable on individually advised insurance cover:

> I am talking about a scenario in which it is a client who is in a group policy. However, that individual client seeks advice from an adviser about the level of insurance cover, as an example, but because it is a group policy the one individual is getting advice on, that adviser is unable to receive remuneration as a commission because it is a group policy. That adviser could say, 'I can take you out and put you in a different policy where I will be paid commission', but we do not think that is appropriate. There should be individual advice provided to that person. We want the legislation to be quite clear that where individual advice is being provided that commission should be payable as it would be if it was a personal policy inside superannuation.[33]

1.116 Mr Gareth Hall, Board Member/Treasurer of the Corporate Superannuation Specialist Alliance stated that the proposed ban was illogical and could lead to consumers missing out on some very important benefits:

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32 Association of Financial Advisers, *Submission 31*, p. 11.

33 Mr Dante De Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard,* 23 February 2012, p. 36.

> On the subject of insurance commissions, we believe that it is totally illogical to ban insurance commissions on group insurance inside superannuation. Contrary to the evidence provided to the PJC by some groups, there is not upfront commission on group insurance of up to 130 per cent. There is no upfront commission on group insurance.
>
> Group insurance cover is cover that is arranged to benefit a group of people such as the employees of a company. With group insurance comes significant benefits, such as automatic acceptance, which allows cover to be provided to all members of the plan with no need for medical or other underwriting. It is automatic. This can be an enormous benefit to someone who may otherwise be uninsurable due to a past illness or accident. There is no churn with group insurance policies. There is no benefit to move between insurers unless there is a lower cost to benefit the members.[34]

1.117 At the Committee hearings Mr Klipin outlined the concerns of the AFA at possible market distortions and arbitrage if the proposed ban is implemented:

> It was very clear from the start, and that is that the remuneration model in insurance, whether it is individual or group, it works, it is annual, clients have the option to opt-in and opt-out and so on; they should be allowable whether the group plan is inside or outside super. The remuneration model is agreed between the adviser and the client; end of story. Having an arbitrage and different set-up inside and outside super will only distort the market, it will only confuse consumers and, ultimately, it is going to create marketplace distortion where sometimes it might be better for a client to be outside of super where they ought to be inside of super, and that is just a silly arrangement to be in.[35]

1.118 Mr Gareth Hall from the Corporate Superannuation Specialist Alliance highlighted that the proposed ban would increase the problem of underinsurance in Australia:

> If the proposed banning of commissions in group insurance within superannuation is implemented and there is no ability for advisers to charge a fee for their service it will mean that we will be forced to withdraw our services. In our opinion, this will not benefit anybody and will not lead to a reduction in costs. The services we provide will either not be provided or will be provided reactively by insurance companies. There is already a problem with underinsurance in Australia, and this will only serve to exacerbate the problem.[36]

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34 Mr Gareth Hall, Board Member/Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard,* 23 February 2012, p. 9.

35 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Proof Committee Hansard,* 23 February 2012, p. 52.

36 Mr Gareth Hall, Board Member/Treasurer, Corporate Superannuation Specialist Alliance, *Proof Committee Hansard,* 23 February 2012, p. 9.

1.119 Coalition Senators believe that where possible such opportunities for market distortions and 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.

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

1.121 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

1.122 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

1.123 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

1.124 As stated above, Coalition Senators 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.

1.125 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.

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

(i) Monetary conflicted remuneration;

(ii) Non monetary conflicted remuneration; and

(iii) Other banned remuneration such as shelf space fees.

Monetary conflicted remuneration

1.127 In its submission to the Parliamentary Joint Committee on Corporations and Financial Services, which also inquired into these Bills, the Law Council of Australia expressed its concern 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).[37]

1.128 ABA and FSC argued that remuneration relating to general advice should be exempted from the ban, as 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.[38]

1.129 The Financial Services Council 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.[39]

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37 Law Council of Australia, *Submission 5* to the Parliamentary Joint Committee on Corporations and Financial Services, p. 9.

38 Financial Services Council, *Submission 18*, p. 76.

39 Financial Services Council, *Submission 18*, p. 79.

1.130 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 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.

1.131 This concern was also strongly expressed by Westpac in its submission to the Committee.[40]

1.132 Coalition Senators 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

1.133 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.

40 The Westpac Group and BT Group, *Submission 37*, p. 22.

Non monetary conflicted remuneration

1.134 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.

1.135 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 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.[41]

1.136 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.

1.137 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.[42] Coalition Committee members recommend that this uncertainty should be clarified by amendment to the Explanatory Memorandum.

1.138 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

41 Financial Services Council, *Submission 18*, p. 81.

42 Financial Services Council, *Submission 18*, pp 81–82.

legislation also restricts training to that which is 'relevant to the provision of financial advice'.

1.139 In its submission to the Parliamentary Joint Committee on Corporations and Financial Services, which also inquired into these Bills, 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.[43]

1.140 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.[44]

1.141 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

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43 AMP Financial Services, *Submission 43* to the Parliamentary Joint Committee on Corporations and Financial Services, p. 23.

44 Financial Services Council, *Submission 18*, pp 82–83.

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.

1.142 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.[45]

1.143 To address the concerns expressed to the Committee about the ban on non monetary benefits, Coalition Senators 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

1.144 In relation to 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**

45 Financial Services Council, *Submission 18*, p. 84.

(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

1.145 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.

1.146 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.[46]

1.147 The FSC expanded on its concerns in relation to volume-based shelf-space fees at the Committee hearings:

Mr Brogden: The first thing is that what you are basically asking a fund manager to do is to disclose their profit margin. There are very few areas of legislation, to my knowledge, where you ask a provider of a service to disclose their profit margin. The second thing is that the arrangement that is provided to a platform or a super fund by a fund manager to benefit scale varies from one client to another. XYZ Fund Management may provide one discount here and provide a different discount to the next player. They may provide different investment services which also carry a different outcome. The risk is that you are effectively asking the fund manager to publicly disclose, through this reasonableness requirement, their IP, their intellectual property, that exists in their product.

It is an extraordinarily competitive industry, fund management, as Senator Sherry knows. There is $1.8 trillion of funds under management. The largest single player, Colonial First State Global Asset Management manages $150 billion, of which $100 billion is Australian funds. There are very few other areas in financial services in Australia where the biggest player manages less than 10 per cent, so it is ruthlessly competitive, to the

46 Financial Services Council, *Submission 18*, pp 59–60.

> end benefit of the consumer. But it, therefore, critically involves different IP. If you are asking a fund manager to effectively open up the cupboard and say, 'Here's our profit margin and here's our IP', you are stripping out the competition in the game and you will see a disbenefit provided down the line to the individual client.
>
> ...
>
> Ms Storniolo: It is the definition of the way the legislation is reading at the moment. First of all, it does not define what this thing is. It says, 'Shelf space fees are conflicted', but it does not define what a shelf space fee is. It says that it is something that is determined by number value so therefore it has a connection to volume, but it does not define it. It then says, 'You can receive it if it is a rebate that does not exceed the reasonable scale benefit that a fund manager has.' Each super fund, to be able to receive this money, would have to stand in judgment of every fund manager and every asset class that they have to determine, 'Is this rebate I'm receiving from this fund manager in accordance with this legislation that allows me to receive it?'[47]

1.148 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 latforms of fund managers for preferential programs. There is agreement that these volume based shelf space fees should be banned.

1.149 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.

1.150 To address these concerns the Coalition Senators have made a series of sensible recommendations that give effect to the government's stated policy intention

47 Financial Services Council, *Proof Committee Hansard,* 24 February 2012, pp 5–6.

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

1.151 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

1.152 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.

1.153 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.

1.154 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.[48]

1.155 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:

> 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.[49]

1.156 Professional Investment Services also articulated their specific concerns about the grandfathering provisions as follows: Following is PIS's explanation of the grandfathering issue, Submission 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

48 Australian Bankers Association, *Submission 23*, p. 40.

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

> 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.[50]

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

Recommendation 13

1.158 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

1.159 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.

1.160 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.

1.161 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.[51]

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

51 Financial Services Council, *Submission 18*, p. 38.

1.162 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.[52]

1.163 At the Committee hearings, Ms Cecilia Storniolo, Senior Policy Manager from the Financial Services Council expressed concerns that the measure was introduced only a week after it had first been issued for consultation:

> The antiprovision measure appeared and was tabled in parliament a week after it was actually issued for consultation with the industry. It was the first time the industry had seen those provisions. There was not any time for the industry to actually comment on those provisions before they were tabled in parliament. Since they have been tabled in parliament we have had a number of members express concerns about the provision. A couple of key concerns include the fact that the provision does not recognise that payments that are lawful are exempt from the provision. It does not recognise that payments et cetera that are actually exempt from the legislation are also permitted. It basically makes everything fall foul of the bills. We ask that the committee have a look at that provision in particular and address those nuances to ensure that payments that the legislation permits, payments that the legislation exempts et cetera, are carved out from that provision and that a provision only apply prospectively.[53]

1.164 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

1.165 The anti-avoidance provision must only apply prospectively and not capture or render existing legal arrangements as unlawful. The provision should

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

53 Ms Cecilia Storniolo, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard,* 24 February 2012, p. 7.

be amended to carve out legally permitted, exempted or grandfathered arrangements.

New ASIC powers

1.166 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.

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

1.168 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.

1.169 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.

1.170 The Joint Accounting Bodies expressed their concerns about how ASIC proposed to use these new powers and concerns about how ASIC would interpret the terms 'believe' and 'likely to contravene' contained in the new powers.[54]

1.171 The Financial Planning Association requested further clarification and detail around how ASIC will apply their enhanced powers.[55]

1.172 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.[56]

1.173 Coalition Senators 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.

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54 Joint Accounting Bodies, *Submission 21*, p. 5.

55 Mr Dante De Gori, General Manager, Policy and Government Relations, Financial Planning Association of Australia, *Proof Committee Hansard,* 23 February 2012, p. 33.

56 Financial Services Council, *Submission 18*, p. 21.

1.174 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

1.175 That the Senate 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

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

1.177 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.

1.178 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.

1.179 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.

1.180 Coalition Senators 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.

1.181 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.

1.182 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.

1.183 Coalition Senators 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

1.184 That the FOFA legislation be amended to:

- **(i) Provide a comprehensive definition of the term 'intra fund advice';**
- **(ii) Ensure that 'intra fund advice' is general in nature only, similar to the provisions relating to basic banking products;**
- **(iii) Ensure that any financial advice accessed within a superannuation fund beyond such general advice be expressly subject to the best interests duty;**
- **(iv) 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**
- **(v) Repeal the existing ASIC Class Order exemption as it would be superfluous once intra-advice is properly defined within the FOFA legislation.**

Senator David Bushby
Deputy Chair

Senator Mathias Cormann
Senator for Western Australia

APPENDIX 1

Submissions received

Submission Number	Submitter
1	Suncorp Group Limited
	• Supplementary Submission
2	Confidential
3	Confidential
4	Mr Richie Parsons
5	Industry Super Network
	• Supplementary Submissions
6	Abacus - Australian Mutuals
	• Supplementary Submission
7	Trustee Corporations Association of Australia
8	Burrell Stockbroking and Superannuation
	• Supplementary Submission
9	Australian Securities and Investments Commission
	• Supplementary Submission
10	Self-Managed Super Fund Professionals' Association of Australia
11	AustralianSuper
12	MoneyLink Financial Planning Pty Ltd
13	FYG Planners Pty Ltd
14	The Trust Company Limited
15	Matrix Planning Solutions
16	Vanguard Investments Australia Ltd
17	Professional Investment Services Pty Ltd
	• Supplementary Submission

18	Financial Services Council
19	Macquarie Bank Limited
20	Financial Planning Association of Australia
21	Joint Accounting Bodies
22	Australasian Securities Dealers Association
23	Australian Bankers' Association Inc
24	McCullough Robertson Lawyers
25	Accommodation Association of Australia
26	The Association of Superannuation Funds of Australia Limited
27	Australian Timeshare and Holiday Ownership Council Ltd
28	Classic Holidays
29	Superannuation Complaints Tribunal
30	Wyndham Vacation Resorts Asia Pacific Pty Ltd
31	Association of Financial Advisers Ltd
32	LifeNet(WA) Financial Advice Pty Ltd
33	National Insurance Brokers Association of Australia
34	Trustee Corporations Association of Australia
35	Australian Institute of Superannuation Trustees
36	Gold Coast Tourism
37	The Westpac Group and BT Financial Group
38	The Holiday Club
39	Financial Ombudsman Service
40	ANZ Wealth • Supplementary Submission
41	Joint Consumer Groups • Supplementary Submission
42	Chartered Secretaries Australia Ltd
43	Queensland Tourism Industry Council

44	MLC Limited and NAB Wealth (MLC)
45	Insurance Council of Australia
46	Australasian Compliance Institute
	• Supplementary Submission
47	Stockbrokers Association of Australia
	• Supplementary Submission
48	Corporate Superannuation Specialist Alliance
49	Senior Australians Equity Release (SEQUAL)
50	Mr Mervin Reed, Financial Adviser
51	Mr Michael Peters
52	AMP Financial Services

Additional information received

- Received from the Department of the Treasury on 24 February 2012; answer to a Question on Notice taken at a public hearing in Canberra on 23 February 2012.
- Received from Wyndham Vacation Resorts Asia Pacific Pty Ltd on 27 February 2012; answer to a Question on Notice taken at a public hearing in Canberra on 23 February 2012.
- Received from The Association of Superannuation Funds of Australia Limited on 1 March 2012; answers to two Questions on Notice taken at a public hearing in Canberra on 24 February 2012.
- Received from Abacus - Australian Mutuals on 2 March 2012; answer to a Question on Notice taken at a public hearing in Canberra on 23 February 2012.

APPENDIX 2

Public hearings and witnesses

CANBERRA, 23 FEBRUARY 2012

AGLAND, Mr Reece, Manager, Member Integrity, Institute of Public Accountants (representing Joint Accounting Bodies)

ANDERSON, Mr Philip, Chief Operating Officer,
Association of Financial Advisers Ltd

BIRD, Associate Professor Joanna, Sydney Law School, University of Sydney (representing Joint Consumer Groups)

CAMPO, Ms Robbie, Manager, Strategy, Industry Super Network

CLARK, Mr Douglas, Policy Executive, Stockbrokers Association of Australia

De GORI, Mr Dante, General Manager, Policy and Government Relations,
Financial Planning Association of Australia

ELVY, Mr Hugh, Head, Financial Planning, Institute of Chartered Accountants (representing Joint Accounting Bodies)

HALL, Mr Gareth, Board Member and Treasurer,
Corporate Superannuation Specialist Alliance

HORSFIELD, Mr David, Chief Executive Officer and Managing Director,
Stockbrokers Association of Australia

KLIPIN, Mr Richard, Chief Executive Officer, Association of Financial Advisers Ltd

LATTO, Mr Douglas, President, Corporate Superannuation Specialist Alliance

LAWLER, Mr Luke, Senior Manager, Public Affairs, Abacus - Australian Mutuals

LINDEN, Mr Matthew, Chief Policy Adviser, Industry Super Network

MURPHY, Mr Jim, Executive Director, Markets Group, Department of the Treasury

POWELL, Mr Stephen, Policy Analyst, Financial Advice Reform Unit,
Retail Investor Division, Department of the Treasury

ROBINSON, Mr Barry, President,
Australian Timeshare and Holiday Ownership Council Ltd

SANDERS, Dr Deen, Chief Professional Officer,
Financial Planning Association of Australia

SANDLANT, Dr Richard, Manager, Financial Advice Reform Unit,
Retail Investor Division, Department of the Treasury

VROOMBOUT, Ms Sue, General Manager, Retail Investor Division,
Department of the Treasury

WALLER, Mrs Keddie, Policy Adviser, Financial Planning, CPA Australia
(representing Joint Accounting Bodies)

ZINN, Mr Christopher, Director, Campaigns and Communications, Choice
(representing Joint Consumer Groups)

CANBERRA, 24 FEBRUARY 2012

BROGDEN, Mr John, Chief Executive Officer, Financial Services Council

GALBRAITH, Ms Fiona, Senior Policy Adviser,
The Association of Superannuation Funds of Australia Limited

GRAY, Ms Heather, Chair, Superannuation Committee, Law Council of Australia

KELL, Mr Peter, Commissioner, Australian Securities and Investments Commission

LEVY, Ms Michelle, Member, Superannuation Committee, Law Council of Australia

PRICE, Mr John, Senior Executive Leader,
Australian Securities and Investments Commission

RICKARD, Ms Delia, Senior Executive Leader,
Australian Securities and Investments Commission

STORNIOLO, Ms Cecilia, Senior Policy Manager, Financial Services Council

VAMOS, Ms Pauline, Chief Executive Officer,
The Association of Superannuation Funds of Australia Limited