Association of Financial Advisers

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The Manager
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: FSRCconsultations@treasury.gov.au

Dear Treasury,

AFA Submission: Ongoing Fee Arrangements and Disclosure of Lack of Independence

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA welcomes the opportunity to make a submission on the draft legislation to implement annual renewal and disclosure of lack of independence. It is our view that getting the right balance in the legislation on annual renewal will be critical, to ensure that necessary consumer protections are in place, but also that the cost of financial advice does not place it out of the reach of everyday Australians.

The AFA supports arrangements that allow clients to readily confirm what they are paying for financial advice and to regularly consent to the payment of ongoing advice fees. We believe that systems and processes that are set up to achieve this outcome need to be efficient and streamlined. Ultimately automation and system-based solutions need to play an important role in achieving this.

The current FDS and Opt-in/Renewal processes are, however, both inefficient and of limited value to clients. FDSs are difficult for licensees and financial advisers to prepare and due to a range of factors explained below, are prone to error, whilst Opt-in notices typically add very limited value as they are nothing more than an administrative exercise to confirm client consent to an existing agreement that is not actually restated in the Opt-in notice. It is a bureaucratic exercise, rather that delivering any real value to the client. There is a significant opportunity to achieve a substantially more efficient process and a better outcome for consumers. The Opt-in obligation works off a very tight deadline for obtaining client consent that does not align to the demands of client lifestyles or their needs. Financial advice clients are on average much older than the overall population, and as such, many of them are retired. They therefore are more likely to be travelling, or as they get older, to be unwell. This, along with busy lives including helping their children and caring for grandchildren, makes tight deadlines problematic.

The draft legislation puts forward a model that significantly adds to complexity and red tape. The overall objective of this process should be to confirm the client's ongoing agreement to the continuation of advice services. The proposal now results in three documents in addition to the existing client service agreement. Financial advisers will now need to prepare an agreement, an FDS, an Opt-in notice and one or more consent forms. The finalisation of the legislation to implement this Royal Commission recommendation, is clearly a great opportunity for rationalisation if there is a greater focus upon efficiency, streamlining and client value. The greatest concern that we have with respect to this proposal is that it will significantly add to the cost of providing financial advice and result in financial advice becoming inaccessible and unaffordable for everyday Australians. We have put forward a model below for rationalisation that addresses the objectives of the regime, and the recommendations of the Royal Commission.

The model proposed by this draft legislation is actually a 15 month renewal model, as financial advisers will have 60 days after the end of the year to issue the FDS and Renewal notice and clients then have 30 days to sign the Renewal notice. The cycle is then reset according to the date that the client signs. This is, in our view, inconsistent with the Royal Commission recommendation and it is not in the best interests of those clients who wish to meet with their adviser at the same time each year for an annual review. This problem fundamentally arises as a result of the linkage of the FDS statement to the Renewal exercise. Given that the FDS notice covers a 12 month period and the adviser needs time to prepare it after the end of the 12 month period, this means that the cycle will always be moving and extending beyond a 12 month period. This will also cause issues in that there may be gaps between the periods covered by each FDS. We propose an alternative solution to overcome this problem, by disconnecting the FDS and the Opt-in notice.

We have observed in recent years an increasing level of support by industry funds to engage with financial advisers. This has included giving them access to the product system to check client data (subject to client consent), and enabling financial advisers to be paid directly from the client's account with the fund. This is in the interests of all stakeholders, as it better allows industry fund members to access comprehensive financial advice and it better enables financial advisers to support their clients in these products. We strongly support this trend, which also serves to reinforce the separation of advice from product and creates an open architecture world.

It is our fear that the increased obligations and costs for superannuation funds, that will go along with the requirement to obtain client consent, may discourage some industry funds from embracing financial advice and giving their members access to comprehensive financial advice. This would be a very unfortunate outcome for all stakeholders and one the Government should guard against.

We have set out below a recommendation for a fundamentally different approach to addressing recommendation 2.1 on Annual Renewal and Payment. Noting the Government's obvious determination to implement these reforms exactly as proposed and without consideration of different, but viable alternatives, and in a particularly demanding timeframe, we have also proposed a model that involves moderate changes to the draft legislation and then another option that involves more minimalistic changes. We have done this at the request of Treasury.

We have worked with other professional associations in our consideration of this matter and some of our recommendations will reflect those put forward by these other associations.

Lack of a Regulation Impact Statement

We note again the lack of a Regulation Impact Statement (RIS), which we consider to be a very serious breach of due process. There is a great deal at stake here, as a poor regulatory outcome will lead to a substantial increase in the cost of financial advice and a resultant significant reduction in accessibility and affordability of financial advice. There have been no costings undertaken and no consideration given to alternative options.

The suggestion, in the draft Explanatory Memorandum, that the Royal Commission was a process equivalent to a Regulation Impact Statement is a deeply flawed statement. The Royal Commission failed to comply with paragraph (k) of their own terms of reference, which required them to “have regard to the implications of any changes to laws, that you propose to recommend, for the economy generally, for access to and the cost of financial services for consumers, for competition in the financial sector and for financial system stability”. The fact that this was not done, or at least not addressed in the final report, is an undisputable fact. If any party believes that this statement is wrong, then we welcome any evidence that they can bring forward. The completion of an RIS is a critical stage in this reform, and a suggestion that it is not required, is simply disrespectful to the financial advice profession and the hundreds of thousands of impacted financial advice clients, who will be detrimentally impacted.

AFA Recommendation Summary

The AFA recognises the Government’s desire to implement the Royal Commission recommendation, however this reform presents an excellent opportunity to address the flaws in the current process and needs to be implemented in a way that avoids additional red tape.We recommend the following:

- Removal of the FDS requirement. This information is already provided in product statements and the workload to prepare them is excessive and subject to a range of issues, and as such prone to errors.
- Opt-In should apply to all ongoing fee clients and the Renewal notice should describe the services to be provided and the fees payable in the upcoming year. Any estimate of fees should be based upon the current circumstances (account balance).
- The client renewal should be for a 12 month period from a fixed date, not the last renewal date, to achieve a genuine 12 month renewal, however with flexibility for the client to sign anywhere between the 9th and 15th month. Greater flexibility will benefit both clients and financial advisers, while still achieving an annual renewal.
- Product provider proof of client authorisation is important, however this does not need to be provided on an annual basis. A sensible timeframe is every three to five years. Other automated solutions need to be considered to avoid this additional red tape.
- We would like to combine the agreement document, the Opt-In Notice and the Consent form.
- Commencement should be deferred until 1 July 2021 and the transition for all clients should be two years, in order to ensure that advisers have sufficient time to work with each client, particularly during the current demanding period, when they are also dealing with other challenges such as the FASEA exam, education requirements, the FASEA Code of Ethics and the transition of grandfathered commission clients. This two year period will enable clients to retain their existing review arrangements.

Background on the Current Renewal Process

The FDS and Opt-in requirements were implemented as part of the Future of Financial Advice Reforms (FoFA), which commenced on 1 July 2013. The objective was to make financial advisers more accountable to their clients and to give clients the opportunity to assess and consider the continuation of their ongoing advice arrangement. The Opt-in obligation only applied to post FoFA clients, whereas pre-FoFA clients were only required to receive an FDS. ASIC provided Regulatory Guidance on the provision of FDSs, however there has been no guidance provided on Opt-in notices. The introduction of FDSs required some fundamental changes to financial planning systems in order to record fees paid by the client, that could be required to be recorded across a 12 month period that could vary from one client to the next.

FDSs need to be prepared on the basis of the fees paid by the client over a one year period. Since this period is determined by the date of commencement of the arrangement, or another day if previously brought forward by the financial adviser, it can be different for every client. They are not done all at the same time, as it would be impossible to prepare them all at the one time, particularly where an Opt-in notice must be issued, and the client must sign within 30 days.

Since the dates are different for each client and most product provider systems are not set up to support this requirement, FDSs are typically prepared from financial planning software (such as XPlan, Coin or Midwinter). There are however, three key limitations:

- Fees may be taken out of the client's account in one period and paid to the adviser in the next period (an issue identified by ASIC in report ASIC 636 - Compliance with the fee disclosure statement and renewal notice obligations). This difference was not understood to be an issue until very recently and was never addressed by ASIC in Regulatory Guide 245.
- The payment to the licensee (and on to the financial adviser) is GST inclusive, as the adviser must collect GST and pay this to the ATO. The client will typically benefit from a Reduced Input Tax Credit (RITC). Thus, there is a difference, between what is taken from the client's account and what is paid to the adviser. ASIC has suggested that advisers should manually check the product system to confirm the correct amount has been used, however no two product systems are the same, and some may include reports that are GST inclusive or exclusive. This issue is not addressed in RG 245 either.
- Advice fees are tax deductible to superannuation funds, and some trustees will pass on a tax credit to the members paying an advice fee. As a result, the effective cost of the fee to the client is reduced. This is not the case with investment products and most (but not all) pension funds.

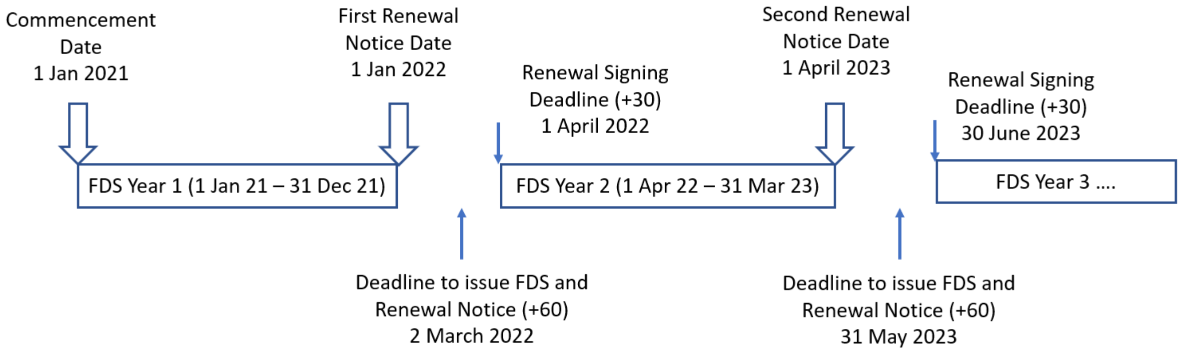
The system for the production of FDSs is highly problematic and subject to a high risk of error. This inefficiency leads to a significantly higher cost (particularly where ASIC has recommended manual checking against product systems) and substantial compliance issues, as addressed in ASIC Report 636. This issue is a bigger factor where a client might hold multiple products that all have fees being deducted, and where it would be necessary to multiple manual checking exercises.

The current FDS system is subject to high levels of red tape and this is all leading to increased costs, which need to be passed on to clients. There must be a better solution, which is something that we address in this submission. It makes no sense to add to the complexity of the current FDS system, whilst making no effort to reduce the red tape or cost to clients.

AFA's Response to the Annual Renewal Consultation

We provide the following feedback on the draft legislation:

- Section 962FA(2) suggests that a client is not taken to have entered into a new ongoing fee arrangement if they give consent under Sections 962R and 962S. From our perspective, this highlights the level of duplication in the forms that clients need to sign, if one that provides consent for the ongoing payment of fees, that is to be provided to a product provider, is not sufficient to commence an arrangement. There is a significant opportunity to reduce this duplication and the level of red tape. This statement seems to work against the prospect of combining the agreement, Opt-in notice and the consent form.
- The repeal of Sections 962G and 962J removes the structures and timing requirements around the provision of an FDS. The current law requires that, unless an FDS is brought forward, the new FDS commences the day after the last day of the previous FDS period. Under the draft legislation, the FDS can be any period, provided that it ends no more than 60 days before the FDS and Opt-In notice are provided. As a result, this will mean that there is a gap between one FDS and the next. As discussed below, there could be up to 15 months between the day that the previous Opt-In is signed and the next Opt-In is signed, and 14 months between the signing of the previous Opt-In and the issue of the next FDS and Opt-In notice. A 15 month renewal outcome is inconsistent with the Royal Commission recommendation.
- Subsection 962H(1)(b)(ii) defines the period for the "upcoming year", which is defined as beginning at the end of the previous year. The previous year is, however, the year that ends no more than 60 days before the FDS and Opt-In were issued. There is no certainty as to when this period will be within the 14 months between the last renewal signing and the last date that the FDS and Opt-in notice need to be provided. If the 12 month period that the FDS year is set to start on the date that the last Renewal notice was signed, then the "upcoming year" could already be 60 days completed when the FDS and Opt-in notice are issued and up to 90 days by the time the client signs the renewal notice.
- We seek clarification as to the intention of Section 962H(2A)(c), as this seems to refer to fees that will be payable in later periods, which seems to be inconsistent with the concept of an annual renewal and consent process.
- Section 962H(2B) enables the inclusion of an estimate of the fees for the following year, but also requires an explanation of the method used to work out the estimate. We would argue that this lacks the necessary clarity of what might be required to estimate fees for the upcoming year, where an asset-based fee is applicable. It is most questionable that the client will get value from the adviser doing a detailed manual assessment and calculation of future contributions, withdrawals and investment returns simply to facilitate this fee estimation. We would suggest that it should be reasonable to prepare this estimate based upon the account balance at the time of the estimate being calculated. This would enable the automation of the "upcoming year" fee estimate.
- It is now Section 962K that sets the dates for the timing of the issue of the FDS and Opt-in notice which results in a period of up to 15 months, being the time between signing the Opt-in notice and then the client signing the next Opt-In notice. This will also create a lack of clarity around the timeframe included in the FDS and the prospect of a gap between the period covered in one FDS and the period covered in the next FDS. The following diagram explains how the renewal could happen every 15 months under the draft legislation, rather than every year, and how there will be a gap between the periods covered in each FDS. This diagram shows that the 12 month FDS period starts immediately on the signing of the previous Renewal notice, however this is not necessarily the case, as it could be any period prior to the point no more than 60 days from the renewal notice date.



- Section 962R seems to relate to situations where the fee recipient is also the product provider, which we would consider to be much less common. Subsection 962R(2)(a), sets out that the client consent is separate to the ongoing fee arrangement, which potentially removes the prospect that they can all be incorporated into the one document, along with the Renewal notice. We will make comment below about Subsection 962R(2)(b), and the prospect of ASIC setting out the requirements of a consent form.
- Section 962S sets out the requirements for where a fee recipient is arranging the deduction of fees from an account provider, who is a separate entity. We ask the question of whether a bank account and a back or credit union, would come under this definition of account provider and whether this same process would need to be followed for fees drawn directly from a bank or credit union account. This seems to be inconsistent with the view put forward in the Royal Commission final report that fees taken from product accounts were 'invisible', when compared to fees taken from bank accounts. We do not support the consent process applying to bank accounts or credit union accounts.
- Section 962S places all the obligations on the fee recipient, and yet places no obligations on the product provider. Recommendation 2.1 includes that "the law should be amended to provide that ongoing fee arrangements may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement". We would argue that this recommendation should place an obligation on the product provider to confirm the consent before making the payment, however this section, and in fact the entire Bill, places no obligations or penalties on the product provider. We question whether this is appropriate and whether it was the intended position of the Royal Commission.
- Section 962S(8) provides relief from the civil penalty provision where an amount taken in breach of the requirement to have consent is repaid within 5 days. It is our view that 5 days is simply not enough time to identify the issue and repay the fees in such circumstances. This should sensibly be extended to 30 days.
- Section 962T provides a power to ASIC to determine the requirements for a consent form. We believe that these requirements need to be kept to a minimum and that this could be solved through regulation, rather than delegation to ASIC. We would suggest that whatever is provided to the product provider should be limited to the specifics of the fee arrangement that relates directly to that product, and should not need to include any detail on the services provided. To best facilitate this, we think that the consent form should be a schedule to the agreement/Renewal notice. It would not be a good outcome if ASIC were to define significant additional information that was required to be included in the consent form, which resulted in pushing up the cost of the production of these consent forms. The requirements of Section 962T may complicate our recommendation to combine the agreement, Opt-in notice and the consent form.
- Section 962U(2) places an obligation on a fee recipient (licensee or Authorised Representative) to respond within 5 business days when they receive a notice from the client that they wish to cancel or vary the agreement. This response includes the need to provide confirmation in

writing to the client and a copy of the notice to the product provider. There are two key issues with this. Firstly, a deadline of 5 business days will be very challenging at the best of times, however it would effectively prevent the office from being closed at the end of the year. Many small financial advice practices would be closed for at least two weeks over the Christmas and New Year period, making this impossible. We recommend an increase to 28 days. Secondly, the suggestion that the financial adviser would need to provide a copy of the client's notice, potentially raises privacy issues. Presumably the client can provide that notice in whichever form they wish, and therefore if it contains information of a private nature, or related to another product holding, then it is inappropriate to provide it to each product provider that the client holds an account with. We also suggest that it would be appropriate to clarify the requirements of the financial adviser in the event of a verbal instruction from a client.

- We note that Section 962V(b) states that consent ends 30 days after the end of the renewal period, which is the last day of the 30 day period after the provision of the FDS and the Opt-in notice. The product providers will not know when the FDS and Opt-In notice were given to the client and will therefore not know when consent ends. This is problematic, if the product provider, is rightly to take some responsibility for ceasing the deduction of advice fees in the absence of consent. Importantly, if there is no expectation on product providers to turn off fees in the absence of a consent form, then why is it proposed that consent forms should be provided to product providers?
- With respect to Section 962X and the retention of records, we note that only the fee recipient has any obligation to retain records. We ask why, if the financial adviser needs to provide the consent forms to the product provider, there is no obligation on the product provider to keep records or demonstrate that they have acted upon these instructions? We further note that record keeping obligations will further increase the cost of this process and that record keeping requirements should be kept to a sensible minimum. We note that this is addressed in the draft regulations. We find the suggestion that a failure to retain adequate records is an offence, and could lead to a jail term, to be completely out of proportion of the severity of the matter.
- We acknowledge that reasons may exist in extreme cases for refund orders, however we would expect that in the vast majority of such cases, this should be resolved by licensee led remediation programs, the Internal Dispute Resolution process or otherwise, by an External Dispute Resolution process. It should never need to come to court action, particularly where this might be on application by the client. We question the need for this provision. We do want to note the circumstance where the adviser has provided notice to the product provider that the client has terminated the arrangement or varied the arrangement, yet the product provider has not actioned this instruction. It is not reasonable for the obligation to rest with the financial adviser, or their licensee, to confirm that product providers are taking the required action.
- In terms of transition arrangements, we put forward the view that a 1 July 2020 start date is completely unreasonable and unacceptable. Even under the Government's proposed Royal Commission implementation road map, there is no expectation that this legislation will be passed by 30 June 2020. This reform represents a fundamental change to the fee disclosure regime and the renewal regime and therefore, it is appropriate for industry stakeholders to have some time to prepare. We are not so much concerned about new clients, as the obligations will not commence until the first anniversary, however with pre FoFA (1 July 2013) ongoing service fee clients, a 1 July 2020 start date and then an expectation that they will have renewed, or at least issued FDSs and Opt-in Notices by 31 December 2020 is just totally unreasonable. Financial advisers have other things to focus on at the moment, such as the exam, degree studies and the removal of grandfathered commissions by 31 December 2020. At the moment, advisers have a lot of additional work within their businesses at the same time as they are studying, and therefore have less time available to work with clients. We believe that it is possible that around a half to two thirds of ongoing fee clients, are pre-FoFA, so this will represent a very substantial workload. At the earliest, we would suggest that the

legislation should commence on 1 July 2021 and advisers should have two years to provide the FDS and renewal notices to these clients. This will enable them to align with the current FDS timeframes, and incorporate the fact that full process can take up to 15 months.

- We seek greater clarity of the requirements of Section 1672D(3). We also seek clarity with respect to the requirements of the similar provisions in Section 1672J(3) and Section 1672K(3). What do these three sections require?
- We also seek clarity with respect to whether Section 1672E requires that consent forms are provided to product providers for all clients by 1 January 2021, or at the next renewal after that date.
- With respect to the transition period under Section 1672H, for post FoFA ongoing fee clients, we also seek a deferred commencement date (1 July 2021) and a two year period to issue the FDS and Opt-in notice to the clients.
- We ask the question of why there are different dates for the requirement to provide the consent form to the product provider for pre-FoFA clients (Section 1672E – 1 January 2021), as opposed to post FoFA clients (Section 1672L – 1 July 2021). We see no reason for these dates to be different.
- We note that there is no obligation to provide consent forms to product providers for fee arrangements that do not qualify under the definition of an ongoing fee arrangement within the Corporations Act (i.e. 12 months or less), however this has been applied differently in terms of the draft legislation in response to Recommendation 3.3 in the SIS Act. We suggest that the difference in the requirements could cause some confusion.

The Cost of Compliance with This Proposal

The clients most impacted in terms of increased costs, as a result of this legislation, are those who are pre-FoFA clients who are not currently subject to Opt-in and pay fees calculated on the basis of an asset-based fee arrangement. In this case, the adviser will need to commence the Opt-in process and prepare an estimate of the fees for the following year. In order to prepare this, the adviser will potentially need to take into account any expected one-off expenditures (i.e. a holiday or the purchase of a new car) or one-off additional contributions (i.e. a non-concessional superannuation contributions or an inheritance), along with expected investment returns. As such it will be necessary for the adviser to talk to the client in advance of the preparation of the FDS, to understand any expected changes in their circumstances (i.e. account balances). Whilst it might be possible to do this over the phone, it is likely that many advisers would arrange a meeting to explain the new requirements.

The adviser would need to prepare the FDS and the fee estimate on the basis of the information obtained in the first meeting and then arrange a second meeting to undertake the annual review and to discuss the FDS and to get the client to sign the Opt-In notice and consent forms. The adviser would then need to forward the consent forms to each of the relevant product providers and update their records accordingly. The potential cost of these additional steps is set out in the following table:

Activity	Time (Hr)	Fees/Hr ($)	Total Fee $
Initial Meeting to Discuss Plans for upcoming year	1 - 2	200	200 – 400
Completion of Fee Estimate	0.5 - 1	200	100 – 200
Preparation of Opt-in notice and Consent forms	1	200	200
Issuing Consent Forms to Product Providers	0.5 - 1	200	100 – 200
Updating records on FDS, Opt-In and Consent	0.5 - 1	200	100 – 200
Total	**3.5 - 6**		**700 – 1,200**

For clients currently paying modest fees, they will most likely become uneconomical to continue to serve and the adviser will need to either significantly increase the fees or discontinue the adviser arrangement. It may be that the adviser can encourage the client to pay more and maybe even assist the client to find savings in order to pay the additional fees, however it is likely that this would result in the discontinuation of many financial advice relationships to the detriment of affected clients.

AFA Proposal for Moderate Changes to the Draft Legislation

Given the current regulatory environment and the Government commitment and determination to implement the Royal Commission recommendations, we have also developed an alternative solution, that is more moderate in terms of modifications to the current draft legislation. The key features of these changes are as follows:

- Importantly, FDSs would be separated from the renewal process. This will provide much greater flexibility and enable a true annual renewal outcome.
- FDSs would be prepared based upon an annual report provided by product providers for the year to 30 June, which would need to be provided by 30 September each year, that sets out fees by each adviser and by each client and account number as at the date of the last annual statement.
- This data should be provided by product providers in a form that can be imported into financial planning software and therefore better enable automating the production of FDSs.
- Licensees and advisers would have 90 days from 30 September each year to prepare and issue these FDSs.
- The renewal day would be a fixed day each year, although advisers should be able to bring it forward if they choose.
- Financial advisers should be able to get clients to sign the new agreement/Renewal at any time between the 9th month and the 15th month, whilst retaining the same annual renewal date.
- The agreement, Opt-In notice and the consent form would be merged into one document where the services for the following year are set out, along with the expected fees. There would be a separate schedule for each product provider that simply sets out the product account and the fee arrangement. The product provider consent schedule could be provided to the product provider through an integrated electronic solution, and thereby avoiding manual administrative processes. This could be done by the licensee as a consolidated licensee report, provided on a monthly basis.
- The services for the following year and the fees would be in the Renewal/agreement form, rather than the FDS, better enabling the stand-alone production of the FDS.
- Fees for the following year, where an estimate is required, could be based upon the account balance at the time of preparation, rather than being calculated based upon any potential adjustment in the client's circumstances. This would enable the automation of the preparation of the estimate for the following year's fees for asset-based fee arrangements.
- Financial advisers would have 28 days to respond to a client when they request to cancel or modify the arrangement and 28 days to communicate with the product provider, although noting that any cancellation would have an immediate commencement and consistent with the current legislation, the adviser should be permitted to recover any outstanding fees and reasonable fees related to processing the termination. The notice to the product provider could be via a standard form, rather than providing the client's written request.
- The legislation should commence on 1 July 2021 and advisers would have two years to issue the FDS and Opt-in notices and to get all existing pre FoFA clients to Opt-In. This would allow product providers sufficient time to develop the annual fees report and allow financial system providers to build the capacity to utilise product provider information on fees in the preparation of FDSs.

AFA Proposal for Minimalist Changes to the Draft Legislation

Given the current regulatory environment and the Government's apparent commitment and determination to implement the Royal Commission recommendations precisely as proposed, we have also developed a further option, that is minimalist in terms of modifications to the current draft legislation. The key features of these changes are as follows:

- The proposed 15 month renewal model would be retained, however the fees disclosed in the FDS would be clearly stated as covering the 12 months commencing on the day after the end of the previous FDS, on the first occasion, and then subsequently the first 12 months from the date of signing the previous Opt-In Notice.
- Financial advisers would have 45 days to issue the FDS and Opt-in notice following the anniversary and clients would have 45 days to sign the Opt-in notice. This will still allow sufficient time for the FDS to be prepared, but also offer greater flexibility to get the client to sign, without impacting the total elapse time.
- FDSs could be presented as GST inclusive or GST exclusive, provided this was disclosed, and based upon when the fees were received by the financial adviser, rather than when they are taken out of the client's account. There would also need to be some level of materiality to allow for small errors.
- The agreement, Opt-In notice and the consent form would be merged into one document where the services for the following year are set out along with the expected fees. There would be a separate schedule for each product provider that simply sets out the product account and the fee arrangement. The product provider schedule could be provided to the product provider on a stand-alone basis.
- The services for the following year and the fees would be in the Renewal notice /agreement form, rather than the FDS.
- Fees for the following year, where an estimate is required, could be based upon the account balance at the time of preparation, rather than being adjusted for any expected changes in the client's circumstances. This would enable the automation of the estimate of the following year's fees for asset-based fee arrangements.
- Financial advisers would have 28 days to respond to a client when they request to cancel or modify the arrangement and 28 days to communicate with the product provider, although noting that any cancellation would have an immediate effective commencement and consistent with the current legislation, the adviser should be permitted to recover outstanding fees and any reasonable fees that are applicable to the termination.
- The legislation would commence on 1 July 2021 and advisers would have two years to issue an FDS and Opt-in notice to all existing pre FoFA clients and to get them to Opt-In.

Obligations for Product Providers

We have noticed with some alarm that the draft legislation places no obligations on product providers or any penalties. Recommendation 2.1 of the Royal Commission clearly states that:

> "the law should be amended to provide that ongoing fee arrangements may neither permit nor require payment of fees from any account held for or on behalf of the client except on the client's express written authority to the entity that conducts that account given at, or immediately after, the latest renewal of the ongoing fee arrangement."

As discussed above, it is our clear expectation of this recommendation, that product providers would have an obligation not to pay fees where they do not have proof of consent and that they would also be subject to civil penalty provisions where they make payment without evidence of consent.

For what reason do financial advisers need to provide copies of client consents to product providers if they have no obligations with respect to acting on those consent forms and no obligations to retain any records of those consent forms. This simply makes it a bureaucratic exercise for no obvious client benefit.

Where the product provider negatively impacts the outcome for the client, then they should face some responsibility. Product providers should not stand in the way of clients achieving their objectives, which might happen where they reject forms and demand unnecessary additional information.

Timeline for Reform

When the Government announced the Royal Commission Implementation Roadmap timeline in August 2019, Annual Renewal was listed as being subject to consultation and having legislation introduced to the Parliament by 30 June 2020. Yet the draft legislation, suggests that these obligations will commence on 1 July 2020, and financial advisers will need to get all pre FoFA (1 July 2013) clients to Opt-in to their ongoing fee arrangements by 31 December 2020. We have suggested above that pre FoFA ongoing service clients most likely represent between half and two thirds of all ongoing fee clients. This is a major reform that will require significant system development and process change. This commencement date and the transition timeframe is totally impractical, particularly in the context of all the other challenges that the financial advice sector is currently facing.

Other Related Issues

There are four other important related issues that we believe need to be addressed as part of this reform process:

- The Sole Purpose Test. APRA is currently reviewing the guidance on the Sole Purpose Test, which is nearly 20 years old. We believe that it is important that this review results in greater clarity in terms of what fees can be paid from a superannuation account. We believe that this should include all forms of advice, that will maximise the retirement savings of clients, including advice on budgeting to enable them to commence a salary sacrifice contribution. We also suggest that the Sole Purpose Test should not prevent the release of money to pay any type of advice fee for clients in pension accounts, given that they have already met a condition of release and can withdraw funds at any time. We trust that APRA will consult with financial advice associations as part of this review.
- It appears that ASIC and some licensees expect that an annual review will have been completed by the anniversary date, with this to be evidenced by the provision of an advice document, and that if this is not the case, then the fees should be refunded. As discussed above, we believe that there should be more flexibility for the client to attend their annual review and that provided it has occurred by the 15 month mark, then this should not require the refund of fees. Often it is the client that dictates the timing of a meeting and it might be that the plans of the adviser to finalise the review before the 12 month deadline becomes unachievable as a result of the emergence of complicating factors in the client's circumstances, which might require further investigation and the development of a new strategy. This is a very important issue that needs to be addressed to ensure that it does not inappropriately interfere with the arrangements that client's have with their adviser.
- On 10 April 2019, APRA and ASIC issued a joint letter that suggested that super fund trustees should seek consent directly from fund members for the continued payment of financial advice fees. Some trustees have commenced processes to this effect. The draft legislation on Annual Renewal, clearly places this obligation to obtain client consent with the financial adviser. We therefore request that APRA and ASIC update their 10 April 2019 letter to clarify this point, and to make it clear that they are not expected to go directly to the client to obtain confirmation of consent.
- The variability of processes and forms across the sector results in complications, administrative

errors and delays that add to the cost of providing financial advice and detrimentally impact the quality of the outcome for clients. We emphasise the importance of consistency across the sector in both processes and the use of standard forms.

Disclosure of Lack of Independence

The AFA broadly supports the proposal with respect to the disclosure of lack of independence and agrees that the Financial Services Guide is the most appropriate place for this disclosure, however we do have some important concerns.

The requirements of Section 923A of the Corporations Act are very restrictive and this provision was written before the introduction of FoFA and the Life Insurance Framework. This section existed before the ban on conflicted remuneration commenced and caps were placed on the receipt of life insurance commissions. We would recommend that as part of this legislation, Section 923A be reviewed to assess whether it is meeting its intended purpose.

We provide the following specific feedback

- We are very conscious of the potential complexity of a full detailed exposure of lack of independence, particularly when some of these matters may not be material, such as the adviser attended a training session held by a product provider (such as the highly regarded training that TAL are providing with respect to preparation for the FASEA exam), or information sessions to explain new products at the time of launch. The tone of the disclosure needs to reflect the substance of the matter.
- The legislation will empower ASIC to issue a legislative instrument to determine the requirements for this lack of independence statement. We express the view that the statement should be measured to ensure that it does not unnecessarily alarm clients, particularly where factors such as product provider training is involved. Equally, with life insurance commissions, where there is a cap that broadly applies to all insurers, the statement should not unnecessarily alarm clients that the exposure is in regard to the selection of one product over another product.
- We note the statement in paragraph 1.5 of the Explanatory Memorandum, which discusses remuneration based on the volume of business. If this is a reference to asset-based fees, then we draw attention to RG 175, where ASIC have expressed the view that asset-based fees do not preclude an adviser from using the term independent. This needs to be clarified.
- The commencement date of 1 July 2020 is totally impractical, particularly given that there is no certainty when this legislation will be passed, although it could most certainly be after 1 July 2020, and implementation is dependent upon the ASIC legislative instrument being developed and issued. It also fails to consider the processes that a licensee needs to work through before the roll-over of an FSG. This would include time for preparation, access to legal advice and then review by committees and the licensee's Board. It is our view that a 1 July 2021 start date is much more practical.

Concluding Remarks

The AFA has devoted significant time to the consideration of the issue of Annual Renewal and we have put forward a range of alternatives. It is our view that this is one of the most critical recommendations of the Royal Commission, and one where the wrong outcome may ultimately lead to a significant decline in access to financial advice and the affordability of financial advice for everyday Australians. We request that our key concerns of efficiency, streamlining and client flexibility are taken into account and that the Government embraces this issue as an opportunity to achieve its objectives whilst avoiding unnecessarily adding to existing red tape.

We broadly support the Lack of Independence disclosure proposal, although noting that this will ultimately depend upon the ASIC Legislative Instrument and the implementation timeframe.

The AFA welcomes further consultation with Treasury, should it require clarification of anything in this submission. If required, please contact us on (02) 9267 4003.

Yours faithfully,

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd