FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

FPA SUBMISSION | SENATE ECONOMICS LEGISLATION COMMITTEE | DATE: 30.04.2014

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

30th April 2014

Dear Sir / Madam

RE: Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide comments on the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*. The proposed amendments present significant changes to the FOFA regime, and we would welcome the opportunity to engage in further consultation with the Committee, the Government and Treasury.

Our submission reflects concerns raised in our previous submission to Treasury regarding the Exposure Draft of this Bill. In particular, we continue to support the removal of the Opt-in requirement, as well as removing retrospectivity from the Fee Disclosure Statement (FDS) regime.

Furthermore, we have noted several substantial improvements to the Exposure Draft that better reflect the policy intent of the FOFA reforms. In particular, restricting the circumstances by which conflicted remuneration can be paid has addressed several of our concerns with the Exposure Draft. Nevertheless, we maintain our view that commissions have no place in financial advice on investment or superannuation products.

We thank you again for the opportunity to consult on this Bill. If you have any questions, please contact me

Yours sincerely,

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia

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PROPOSED FOFA AMENDMENTS

FPA submission to:

The Senate Economics Legislation Committee

30 April 2014

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INTRODUCTION

This submission forms the latest of a series of considered contributions to the formulation of sensible FOFA regulation on behalf of the Australian public.

The Financial Planning Association of Australia (FPA)[1] is committed wholeheartedly to the core principle of placing the client's best interest above all else.

It is enshrined in our Code of Professional Practice as a guiding beacon to those whose endeavor it is to enrich the lives of all Australians through the delivery of high quality, soundly regulated, professional financial advice.

The FPA continues to advocate against any return of commissions on investments and superannuation products and maintains there is a need to improve the efficiency and effectiveness of the FOFA legislation with amendments to the best interests duty, scaled advice and the opt-in and fee disclosure statement measures.

The FPA presents this submission in support of the proposed amendments to FOFA and to clarify some of the myths and misunderstandings being purported in the media and by other stakeholders. To this end we have attached to this submission a copy of our **FOFA Facts** document for your reference.

[1] The Financial Planning Association (FPA) represents more than 10,000 members and affiliates of whom 7,500 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- We banned commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Professor Dimity Kingsford Smith, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

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THE BEST INTERESTS DUTY

The FPA believes that acting in the best interests of the client is a hallmark of professionalism. For the most part, the existing statutory 'best interests duty,' as well as related statutory duties in the Corporations Act,[2] reflect the degree of professionalism we expect as a minimum standard for financial planners and as required under our Code of Professional Practice.

However, the FPA is concerned that the 'catch-all' provisions of the best interests duty (subsection 961B(2)(g) and section 961E[3]) set an unclear and unrealistic expectation for even professional financial planners. We argue that;

- the words in the legislation "taken any other step" (subsection 961B(2)(g)) and "take a step" (section 961E) form an open-ended requirement that is practically impossible to satisfy;
- it is not clear what is intended by taking "any other step" that is not already covered in the other provisions of section 961B;
- the consumer protection offered by the catch-all is less effective than the general law as it can only be realised through litigation by ASIC, and;
- the standard of conduct intended by the 'catch-all' provision cannot be mandated by legislation or originate from the judiciary, but must emerge from a confluence of hard and soft regulation, legislation and self-regulation, and innovation.

This lack of clarity opens significant litigation risks for financial planners that are only tenuously connected to a consumer protection benefit. Removing these provisions does not water down the consumer protections of the FOFA regime. Financial advice must still be in the client's best interest (section 961B), appropriate for the client (section 961G), and the financial planner must still prioritise the client's interests (section 961J) ahead of their own.

Further, subsection 961B(2)(f) requires professional judgement as one of the steps of the best interest duty. This was not a requirement before FoFA and requires the financial planner to base all judgements they make in advising the client on the client's relevant circumstances. This includes judgement about the scope of the advice, the enquiries they make, the strategies and products they recommend.

Recommendation:

The FPA recommends that the Committee supports items 10 and 14 of Schedule 1 of the Bill which repeal the best interest 'catch-all' provisions.

[2] E.g. the duty to prioritise the client's interests ahead of one's own (section 961J), and the duty to give advice which is appropriate for the client's needs, objectives, and situation (section 961G).
[3] All references to legislation refer to the *Corporations Act 2001* unless otherwise specified.

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SCALED ADVICE

The FPA supports efforts to improve clarity for financial planners who wish to provide scaled advice. However, we believe that additional changes to section 961B are necessary to maintain consumer protection and support the best interest duty.

The key policy objectives in providing a legislative framework for scaled advice are:

- creating certainty for advice providers regarding the matters which may reasonably be excluded from 'fact finds', financial strategy, and product recommendations;
- protecting consumers from unethical business practices, such as negotiating an inappropriate or suboptimal scope for financial advice, and;
- facilitating more efficient and targeted forms of personal financial advice for retail clients, in order to improve access and engagement with our financial system.

We believe that items 11 and 13 of Schedule 1 of the Bill do address these policy objectives. Item 11 amends the note to subsection 961B(2) by clarifying that there is a 'reasonableness' test in order to exclude circumstances from the fact-find process. Item 13 states that the scale of the advice is to be negotiated and agreed upon between the client and the advice provider. These amendments create certainty for financial planners, and have the ability to facilitate scaled advice.

However, we believe that items 7 and 8 are unlikely to have any effect. These items repeal subsection 961B(2)(a), and create subsection 961B(2)(ba) which is materially identical to subsection 961B(2)(a). The intent of these amendments is to clarify that a "full fact-find" is not required for all personal advice, and the relevant circumstances which the advice provider must consider are defined by the subject matter of the advice.[4] We believe that the current subsection 961B(2)(a) does not require a "full fact-find" for all personal advice, and the clarifications to scaled advice make this clear. Finally, the "order" of the steps in subsection 961B(2) provides guidance, but does not dictate how advice providers should satisfy the best interests duty. If anything, the amendments may encourage a lower standard of investigation into the client's relevant circumstances.

Recommendation:

The FPA recommends that the Committee support items 11 and 13 of the Bill.
The FPA recommends that the Committee reject items 7 and 8 of the Bill.

[4] Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 [1.33]-[1.40]

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GENERAL ADVICE

The FPA acknowledges and welcomes that the Government made amendments to the Exposure Draft of the Bill, which will limit the availability of conflicted remuneration, such as commissions, to employees of licensees.

The FPA strongly opposes any possible re-introduction of commissions for financial product advice on superannuation and investment products. There are several risks which are associated with commissions for general advice.

Firstly, we are extremely wary of general advice business models which encourage a complementary 'sales model' of financial product issuance and distribution. The conflicted remuneration which drives these business models poses a real risk of product misselling to retail investors, and was rightly banned by the Future of Financial Advice reforms.

Secondly, commissions incentivise the provision of general advice as a form of consumer education or a replacement for personal advice. General advice is inappropriate for that purpose, and the regulatory regime for general advice cannot address the information asymmetry problems in client/adviser relationships.

Thirdly, commission payments have also eroded public confidence in our financial system. We note ASIC's contribution to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into financial products and services in Australia*;[5]

> *"Commission payments can create real and potential conflicts of interest for advisers. They could encourage advisers to sell products rather than give strategic advice (e.g. advice to the client that they should pay off their mortgage), even if the advice is in the best interests of the client and low-risk. Commissions also provide an incentive to recommend products that may be inappropriate but are linked to higher commissions."*

Australians will not have confidence in our financial system as long as financial advice providers are exposed to perverse incentives such as commissions.

Lastly, allowing superannuation and investment commissions to be paid on general advice has the potential to shift licensees and representatives away from the provision of personal advice in order to earn commissions. As long as the differences between general advice and personal advice are insufficiently clear to consumers, general advice will be perceived as a less costly form of personal advice. This perception of general advice, influenced by the perverse incentives created by commissions, creates an uneven playing field and distorts the market for financial advice in favour of general advice.

However, we do acknowledge that there have also been unintended consequences of the FOFA reforms for general advice providers. On a broad interpretation of section 963A and the term

[5] At [168]

'conflicted remuneration', the ordinary remuneration for general advice providers could be considered conflicted remuneration, even where that advice is limited to basic information about a product. Providing product information to customers does serve a purpose in educating and engaging consumers, especially if that information helps consumers to understand the value of seeking advice.

As the FOFA reforms were intended to protect consumers from unethical sales practices, the existing legislation creates unintended regulatory overreach.

Recommendation:

The FPA recognises that the current Bill reflects amendments to the Exposure Draft which limit the availability of conflicted remuneration to employees of licensees, and thus explicitly excludes financial planners who operate as authorised representatives. However, in order to achieve the policy intent of the FOFA legislation, the FPA recommends that the Bill be further amended to the following effect:

- Sales commissions (both upfront and trailing) should be defined by the Corporations Act and banned with respect to financial product advice on superannuation and investment products.
- General advice should no longer be a form of financial product advice, and instead should be re-termed "factual information" or "financial product information".
- Financial product information/factual information should be regulated with a warning similar to the general advice warning. This warning should make it clear that the information is not financial advice, it is information about a financial product or a class of financial products.
- Licensing and all the other forms of regulation which currently apply to general advice should apply to financial product information/factual information.
- The term Financial planner/adviser should be defined by legislation, in order to prevent individuals who offer financial product information/factual information from representing themselves as financial planners or financial advisers.

The FPA recommends that the Committee engages in close consultation with stakeholders on changes to the general advice terminology and definition.

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OPT-IN AND FEE DISCLOSURE STATEMENTS

The FPA supports the repeal of the Opt-in requirement, as well as the removal of retrospectivity from the FDS regime. We have consistently argued that these two measures have undermined the effectiveness of FOFA. Our view is that they detract from the policy objectives of FOFA by adding regulatory burdens with no clear connection to raising the quality or improving the culture of financial advice in Australia.

While we agree with the policy objective of client engagement, we believe that Opt-in creates an artificial, documentary form of compliance. It also undermines the existing authentic and organic engagement process conducted by professional financial planners, which allows clients to Opt-out at any time. Furthermore, as Opt-in only applies to new clients who sign up to ongoing fee arrangements created from 1 July 2013, clients who pay grandfathered trailing commissions will be unaffected by the Opt-in regime. Lastly, when a client allows an ongoing fee arrangement to lapse under Opt-in, their investments remain in place but unmanaged. This position exposes the lapsed client to significant risk.

The FPA supports prospective FDSs, however we believe that applying the regime retrospectively is a limited, formalistic procedure that does not enhance the adviser-client relationship. Further, the policy intent of the FDS requirement was to improve the disclosure of commissions and assist in phasing out trail commissions. However, commissions are not required to be disclosed in a FDS.

The Explanatory Memorandum notes that an ongoing fee paid by a third party to an AFS licensee or a representative (which would include a commission) will generally not constitute an ongoing fee for the purposes of subsections 962A(1)(c) and 962A(2)(c).[6] ASIC's guidance on the FDS regime states that:

> "*We therefore consider that commissions generally do not need to be disclosed in the FDS, on the basis that they are paid under a commercial arrangement between a product issuer or platform operator and an AFS licensee or a Representative.*"[7]

The retrospective application of the FDS law creates a significant cost for industry and does not deal with the original policy intent of commissions. As this was not previously required, there were no systems in place to record and collect this data at the time the services were provided to the clients prior to the new law commencing on 1 July 2013.

By limiting FDS requirements to clients going forward, the amendments offer a more efficient and effective transition to FOFA while producing the intended consumer benefit of transparency. Accordingly, the FPA supports Items 21 and 22 of Schedule 1 of the Bill which repeal the Opt-in requirement and retrospective fee disclosure statement requirement. However, we are concerned that the wording of section 1531D in Division 2 of the Bill may circumvent the intended starting date for the FDS regime (1 July 2013) by resetting the date to the commencement day of the current Bill. This would effectively create a period of uncertainty between the original FDS starting date of 1 July 2013

[6] Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 at [1.13]
[7] ASIC, Regulatory Guide 245: Fee Disclosure Statements (January 2013), at [38]

and the commencement of the Bill, potentially making the FDS requirement apply retrospectively during this period. The FPA recommends that the starting date for the FDS regime remain as intended by the original FOFA reforms – that is 1 July 2013.

We also remain concerned that the generation of the FDSs can be complicated in several ways: Some information required by the FDS, such as advice fees, may rely on data generation from a third party, and this information sourcing process may be time consuming and prone to delay. For example, where the advice fee is related to asset pricing, data may need to be gathered from multiple third parties, with each being beyond the control of the planner and licensee. This raises the risk of non-compliance with the 30 day period for production of the FDS in subsection 962G(2).

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Recommendation:

The FPA recommends

- the Committee supports Items 21 and 22 of Schedule 1 of the Bill which repeal the Opt-in requirement and retrospective fee disclosure statement requirement.
- the Committee supports an amendment to section 1531D of Division 2 of the Bill making the commencement date for Fee Disclosure Statements requirement 1 July 2013, to reflects the original intent of the Bill to apply to new clients from 1 July 2013.
- the Committee recommend that the legislation be amended to provide financial planners and licensees with either greater flexibility to comply with the FDS 30 day disclosure period where the delay is due to reasons beyond their control OR amend the 30 day disclosure period to 60 days.

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GRANDFATHERING

The FPA is concerned that the grandfathering provisions of the previous Exposure Draft of the *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014* are being delayed.

The current regulations impact require that, when a financial planner or authorised representative changes licensee, any existing benefits under arrangements set up by that financial planner are considered terminated, regardless of whether the client continues their advice relationship with the financial planner.

Furthermore, the uncertainty around grandfathering has caused significant market distortions. Benefits relating to arrangements entered into before 1 July 2013 would potentially be terminated if the business was sold to a financial planner with another licensee, but retained if sold to a financial planner under the same licensee. Different market values have been placed on financial planning businesses up for sale depending on if the purchaser is within the same licensee or with an external licensee. This has already caused a market competition issue with diminished values of client books occurring overnight as a result of the restrictions on the flow of benefits from the new licensee to the financial planner who purchased the books.

The regulations in the Exposure Draft clarify the existing law by allowing grandfathered benefits to be transferred between financial advice businesses, allow authorised representatives to change licensees, and enable representatives to become authorised representatives without affecting grandfathered benefits.

These changes are vital to financial planners and to the financial advice sector. The current grandfathering regulations impact on the fairness and equity of buying and selling of a financial planning business, and potential restriction of trade regarding a financial planner's ability to change employers/licensees. Financial planners may be less likely to change employers/licensees as they would have to forfeit this revenue, impacting their livelihood and making it difficult to comply with best interests duty to their clients. There are also constitutional elements regarding the protection of property rights that need to be considered.

Recommendation:

The FPA recommends that the Committee support the changes to the grandfathering provisions proposed by the previous Exposure Draft of the *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014*.

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TRANSACTION-ONLY SERVICES

In our submission to Treasury regarding the Exposure Draft of this Bill, the FPA noted several problems with allowing commissions in connection with transaction-only services. To a significant extent, the current Bill mitigates these risks by specifying that only employees (and hence not authorised representatives of AFSL holders) may receive conflicted benefits in connection with transaction-only services. Nonetheless, we believe that allowing commissions as a conflicted benefit for transaction-only services creates perverse incentives for individuals and firms, and therefore the Bill should ban commissions for these services as well.

We also remain concerned that complex financial products can be sold on a non-advised basis, especially if commissions are permissible for both general advice providers and transaction-only services. International developments indicate a shift away from permitting complex products to be distributed independently of financial advice or a suitability assessment for the client.[8]

Recommendations:

The FPA recommends that commissions remain banned with respect to transaction-only services (and superannuation and investment advice generally) where connected to complex financial products.

[8] E.g. IOSCO, 'Suitability Requirements With Respect To the Distribution of Complex Financial Products' (January 2013); ESMA, 'Opinion: MiFID practices for firms selling complex products' (February 2014).

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OTHER FOFA AMENDMENTS

The FPA notes that this Bill does not address all the FOFA changes as announced by the Government on 20 December. Many of the outstanding amendments are currently drafted in the Exposure Draft *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014*, which is currently on hold. including changes relating to:

- broadening the circumstances when the grandfathering arrangements for the ban on conflicted remuneration apply;
- clarifying what benefits can be paid under a balanced scorecard arrangement;
- exempting bonuses paid in relation to 'permissible revenue';
- ensuring that the wholesale and retail client distinction that currently applies in other parts of the Act also applies in respect of the FOFA provisions; and
- clarifying the operation of the 'mixed benefits' provisions.

The FPA would urge the Committee to recommend the Government continue to progress these proposed changes through meaningful consultation with all stakeholders, to ensure any resulting amendments produce effective regulation while ensuring consumer protections and the integrity of the financial advice profession.

Recommendation:

The FPA recommends that the Committee ensure thorough and necessary consultation is undertaken to finalise the Exposure Draft of the *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014*.