

27 January 2012

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

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

Dear Sirs,

Future of Financial Advice reforms

The Australian Timeshare and Holiday Ownership Council ("**ATHOC**") is making the following submission in response to the Australian Government's proposals regarding the Future of Financial Advice reforms.

We refer to the two information packs published by the Government dated 26 April 2010 and 28 April 2011 (referred to in this letter as the "**2010 Information Pack**" and the "**2011 Information Pack**" respectively) and the *Corporations Amendment (Future of Financial Advice) Bill 2011 (FOFA Bill)* and *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (FOFA Further Measures Bill)* (together **FOFA Bills**).

1. Background to ATHOC and the timeshare industry

- 1.1 Established in 1994, ATHOC is a not-for-profit industry body whose membership categories represent all types of interests involved in the Australian timeshare industry. ATHOC's members include vacation resorts and resort management members, timeshare owners, developers and promoters, marketers, timeshare exchange companies and organisations providing professional advice to the timeshare industry. ATHOC is governed by an elected board and operates through three regional committees (Northern, Southern, and Western). Membership is not automatic, and is open to all those directly or indirectly involved in timeshare. All ATHOC members are required to adhere to a Code of Ethics and a comprehensive Code of Practice drawn up by ATHOC.
- 1.2 ATHOC's responsibilities include supervising and monitoring the activity of its members, ensuring their compliance with regulatory requirements, preparing and providing reports to ASIC, and identifying systemic problems and reporting serious misconduct to regulatory authorities.
- 1.3 By way of background, timeshare schemes are generally regulated as registered managed investment schemes in Australia, and the responsible entity of a timeshare scheme must be a public company that holds an appropriate AFSL allowing it to operate and provide financial services to the scheme. Timeshare schemes deal with both real and personal property. Their purpose is not to generate a financial return for the purchaser and are structured in a way that would not yield the purchaser any substantial financial return. The most common purpose of

timeshare is to provide holiday/lifestyle options for unit-holders. Examples of the major types of timeshare include:

- (a) title-based timesharing schemes, whereby a person becomes a tenant in common with others, and ownership is evidenced by a certificate of title to the real property and membership of a timeshare club;
- (b) company structured timesharing schemes under which a person owns shares in a company that owns and operates a vacation resort;
- (c) "right to use" schemes, whereby a person acquires the right to occupy a resort but the developer retains ownership of the property;
- (d) unit trust or other trust-based schemes, under which a trustee acquires a property and holds it on trust for members for a defined period;
- (e) points-based timesharing schemes in which different classes of members hold different numbers of points which are redeemed for accommodation or other benefits and which are generally renewed annually or at other specified intervals.

1.4 Timeshare issuers usually generate sales in timeshare by employing authorised representatives, arranged in sales centres, to sell their products - being interests in their managed investment schemes and any other ancillary products, for example 'top-up' credits to increase the range of vacation options open to owners.

2. Prohibition on all commission payments and volume-based payments and other conflicted remuneration structures

2.1 We understand that the proposed reforms will prohibit the payment of any form of conflict-based remuneration structures in connection with the provision of advice for retail financial products. This will include commissions, volume-based payments or payments made to advisers that are dependent upon meeting sales targets in relation to retail products or investments.

2.2 In the table on page 13 of the 2010 Information Pack, it states that "*Payments from licensees to their employee advisers or employee representatives for distribution of retail financial products, which are calculated based on meeting sales targets or are volume based*" will not be permitted.

2.3 This is confirmed on page 10 of the 2011 Information Pack, which states that the following will be caught by the proposals:

"Any volume-based payment from a product provider, platform provider, or any other entity to a licensee, authorised representative or adviser in relation to distribution or advice for retail financial products..."

Any volume-based payment from licensees to their employee advisers or authorised representatives for distribution of retail financial products, contingent or based on meeting sales targets..."

2.4 This would capture remuneration structures between timeshare companies and their sales centres that were dependent upon the volume of investment generated in the companies' products. It would include salary structures that rewarded an employee on the basis of the number of their employer's products they sold, and bonuses that were dependent on sales targets being met, either collectively or individually.

We understand from discussions with ASIC that the proposed prohibition on commissions and volume-based remuneration are not intended to apply to the timeshare industry. However in the event this is not the case, we make this submission for an exemption based on the reasons set out below.

Employee advisers often do not have a choice of products

- 2.5 The proposals are grounded in the assumption that, when an adviser is remunerated by means of commission or on a volume basis, there is a conflict in the advisory process: the adviser is financially incentivised to recommend one product over another, perhaps more suitable product, because he or she will receive a bigger salary, bonus or commission for selling that product.
- 2.6 In the case of timeshare, however, representatives employed exclusively by one issuer do not have a choice of products from which to select when advising clients. All primary timeshare issuers in Australia only operate one scheme and there is only one type of holiday managed investment scheme available for purchase. These interests are not sold for the purpose of making a financial return nor do the representatives offer any kind of financial planning or personal financial investment advice that consider all the relevant factors such as the client's investment aims and resources. Indeed, the various exemptions granted by ASIC to the timeshare industry are on the basis timeshare is not promoted as an investment. The AFSL granted to timeshare companies by ASIC does permit the giving of personal advice however timeshare representatives and companies are not permitted to give financial investment advice and sanctions can be invoked against companies if they do provide such advice. Additionally, there can be no conflict of the type described in paragraph 2.5 above if the representative is not required to make any product selection in order to advise the client.
- 2.7 Most, if not all issuers also allow timeshare owners/unit-holders to purchase 'top-up' style credits, to enable them to have access to a wider range of vacation options within the scheme. Again, there is no conflict of the type described above because they are interests in the existing scheme.

'Best interests' duty should already achieve the desired end

- 2.8 To the extent that there is an incentive for a representative to recommend a larger purchase than is suitable for the investor, because the representative's remuneration is volume based, we submit that the proposed statutory fiduciary duty on representatives when giving personal advice to retail clients should be sufficient to address this behaviour.
- 2.9 On page 12 of the 2011 Information Pack, it states:
- "Treasury has been consulting with stakeholders on various formulations of a duty that would require a person providing personal advice to a retail client to act in the best interests of the client and, if there is a conflict between the client's and the interests of the person providing personal advice or the providing entity, to give priority to the client's interests..."*
- 2.10 In the "Frequently Asked Questions" document on the Future of Financial Advice website, it states that "the outcome of the statutory fiduciary duty will be to clarify for all parties that in no circumstances is it permissible for advisors to put their interests ahead of those of their client. The proposed duty recognises that conflicts exist in many cases, but will require that advisors ensure that they do not prefer their own interests over those of their clients, thereby compromising the quality of advice."
- 2.11 If a representative is tempted to advise a retail client to purchase a larger amount of timeshare than may be in the client's best interests, the statutory fiduciary duty should prevent them from doing so.

- 2.12 We note further that while the AFSL held by the responsible entity of many timeshare companies does allow the giving of personal advice, this advice is limited to providing advice on the purchase of a lifestyle product and not an investment product.

Carve-out for sale of ADI's basic banking products by employees of the ADI

- 2.13 We understand that there will be a carve-out from the prohibition on conflicted remuneration structures and the statutory fiduciary duty for employees of Australian Deposit-taking Institutions (“ADIs”) advising on and selling their employer ADIs’ basic banking products.

- 2.14 On page 15 of the 2011 Information Pack, it states that:

“... The ban on payments relating to volume or sales also extends to employee remuneration calculated based on sales and volume targets.

During implementation consultation, some concerns were expressed about the measures, particularly relating to their application to the more straightforward retail banking products, given the compliance burden of the measures as well as significant changes to employee remuneration and workplace arrangements, in light of arguments that there is not the same level of conflict, risk and potential impact on the advice process.”

- 2.15 The rationale provided on page 16 for the carve out is that “while these employees may provide either general or limited personal advice in relation to these basic banking products, these products are generally easier for consumers to understand, and consumers more readily understand that the frontline employee of the ADI is in the business of selling the employer's product.”
- 2.16 We submit there is no material difference between the situation of the ADI employee adviser giving advice on the basic products offered by their employer – we note that they even have a choice of investments from which to make a recommendation – and the timeshare company representative giving advice on timeshare products issued by their employer.
- 2.17 Timeshare is generally a well understood product. Despite being constituted as a managed investment scheme, it is not a complex, structured product. Its purpose is not to make a financial profit, but rather to provide investors with vacation options. Like ADIs, timeshare companies generally arrange their sales teams by means of a sales office such that consumers appreciate that the representatives they purchase their timeshare from are employed by the timeshare company and their job is to sell the product. In our opinion, the situation is exactly analogous to that of the ADI employee.

Applying the ban to the timeshare retail space will not achieve increased investor protection levels in the realm of financial advice

- 2.18 Furthermore, since timeshare is not about generating a financial return for investors, but rather providing holidaying options for holders, banning commissions paid to staff who are remunerated on a volume basis will not result in a material improvement in investor protection levels in relation to financial advice. We submit that a blanket application of the principle to include the sale of timeshare by employees of timeshare companies is too broad-brush and goes beyond what is necessary to achieve the aims of the reforms.

Suggested alternative approaches

- 2.19 One way to avoid timeshare companies from being unjustifiably caught by the ban on commissions and volume-based payments would be to extend the carve-out for ADI employees to employees of timeshare companies selling their employer's timeshare products. This would address the concern that timeshare advice is not financial advice in the typical sense and it would put employee representatives of timeshare issuers on the same footing as

employee advisers of ADIs. Since the rationale for allowing ADI employees is equally applicable, in our opinion, to timeshare issuer employees, we believe that this would be a fair outcome.

2.20 If the Government is not prepared to extend the carve-out to timeshare issuers in this way, we would suggest an alternative approach of a carve-out for commissions and volume-based payments in the following circumstances:

- (a) where a representative does not have a choice of products to select from, but only has one product to sell; or
- (b) where the amount of commission a representative receives from his or her employer does not vary depending on which product they sell to a client.

Any concerns about a representative being incentivised to recommend a greater investment amount out of self-interest would be addressed by the statutory fiduciary duty.

3. Potential adverse impact of reforms not in line with the underlying policy of the FOFA reforms

3.1 Most representatives of timeshare companies are paid a basic retainer but rely on commission based on the number of timeshares sold by them to make up the rest of their earnings. Sales managers and directors, as well as executive management, may also receive commission and/or a bonus linked to the sales performance of the company or specific offices or regions.

3.2 If the proposals are passed in their current form and companies are no longer allowed to reward staff financially according to their sales performance, this will have a potential adverse impact on timeshare companies, their employees, the timeshare industry in the region, and the vendors that rely on the timeshare industry. This adverse impact is not commensurate to any underlying policy outcome being sought and will benefit no one.

3.3 These timeshare companies would be required to change remuneration structures to fixed salary-based remuneration structure. This structure has been used in the past by a number of companies within the region and through the United State and Europe but has not yielded successful results. Hence, it is anticipated that most timeshare companies would be reluctant to adopt such a risky structure that could result in adverse consequences.

3.4 The next best alternatives for the companies is likely to be to move their sales and development functions offshore to other entities within the group or to outsource the functions to overseas providers. Ultimately, these strategies would result in material decrease in the industry in Australia. It is anticipated that this could result in a loss or limitation of the following (without any increased investor protection):

- (a) future resort development;
- (b) direct timeshare related employment jobs;
- (c) indirect timeshare related employments jobs (community marketing employment);
- (d) other businesses that rely on the timeshare industry (suppliers of goods and services that are supported by the timeshare industry);
- (e) substantial taxable income and revenue lost;
- (f) substantial contributions to charities made each year; and
- (g) tourism in general in Australia.

- 3.5 The timeshare industry competes heavily with other industries which pay commissions and are not affected by the proposed reforms to employ the best sales staff. These proposed reforms will result in less attractive salaries, driving away sales staff to other comparable industries that offer more attractive remuneration structures. The industry would stand to lose its best salespeople, many of whom have a strong connection to and understanding of the industry and an excellent grasp of the product.
- 3.6 Based on the reasons given above, we submit that the proposed reforms will provide no consumer benefit and would therefore be a 'dead' expense, ultimately serving no purpose but causing enormous impact on an important industry.
- 3.7 We urge the Government to exempt the timeshare industry from the proposed provisions.

Thank you for your consideration of our submission.

Yours faithfully,

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Australian Timeshare and Holiday Ownership Council Ltd (ATHOC)