AIST submission

Response to Inquiry: Future of Financial Advice (FOFA) Bills 2011

Senate Economics Legislation Committee

January 2012

Australian Institute of Superannuation Trustees

Background

On 26 April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, announced the Future of Financial Advice (FOFA) reforms. The FOFA reforms represent the Government's response to the 2009 Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services (PJC Inquiry), which considered a variety of issues associated with corporate collapses, including Storm Financial and Opes Prime.

Two bills have been introduced to Parliament to contain the FOFA reforms. The first bill, *Corporations Amendment (Future of Financial Advice) Bill 2011* covers the client agreement requirements for ongoing fees and enhancement of ASIC's powers with respect to licensing and banning.

The second bill, *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, covers the best interest obligation for financial advisers, the ban on conflicted remuneration, the ban on volume-based shelf-space fees and the ban on asset-based fees on geared funds.

The reforms focus on the framework for the provision of financial advice. The underlying objective of the reforms is to improve the quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest.

Additional reforms yet to be drafted include:

- Replacement for the exemption currently available to accountants from the provisions of AFSL licensing;
- Definition of the term "financial planner";
- Details of the carve-out of volume based fees associated with capital raisings and other corporate actions undertaken by stockbrokers;
- Grandfathering arrangements for existing clients of financial advisers where there are ongoing fee or commission arrangements; and
- Scaled and intra-fund advice provisions.

AIST

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's $450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

AIST is a registered training organisation and has recently expanded its education program to encompass the growing and changing needs of all members of the not-for-profit superannuation sector.

AIST offers a range of services including compliance and consulting services, events - both national and international - as well as member support. AIST also advocates on behalf of its members to relevant stakeholders.

AIST's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

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Note to this submission

Unless otherwise indicated, please note that all section and subsection numbers referred to throughout this submission refer to those used to number the proposed new or amended sections of the *Corporations Act 2001* ("the Act") and not those of the bills themselves.

1 Executive summary

AIST has also made submissions to the inquiry into these bills presently being conducted by the Parliamentary Joint Committee on Corporations and Financial Services.

AIST strongly supports the intent of the reforms to be implemented by the proposed bills. We consider the conflicted remuneration measures to be a new paradigm in financial advice, where advice provided to members is the primary focus.

In making its submissions to the Senate Standing Committees on Economics, ("the Committees"), AIST confirms the following regarding the proposed bills.

With respect to the *Corporations Amendment (Future of Financial Advice) Bill 2011*:

- AIST supports fee disclosure statements being provided to all ongoing clients, regardless of commencement.
- Where a client-base is sold to another provider, all affected clients should be provided with renewal notices.
- ASIC should provide guidance on the requirements of the fee disclosure statement and renewal notice.
- Additionally to the proposed reforms, we support an increase ASIC's auditing capabilities in line with the concerns raised in the recent ASIC Report 251.

With respect to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*:

- AIST supports the best interests duty covered in the proposed section 961B however we believe that a principles-based approach to this duty would have been preferable.
- We support a new paradigm where financial advice is "the product" and where financial products are mere tools that assist with execution of the advice. We therefore agree that the measures must ensure that the best tools are selected and that the execution is not compromised by inappropriate remuneration arrangements.

AIST is supportive of the proposed reforms regarding ongoing fees for financial advice; however we have a few areas of concern in the bills that we wish to raise. We also note that our understanding of the intent of this policy is to prevent clients being charged for ongoing advice that they do not receive.

1.1 Focus on personal advice provided to retail clients

AIST supports the intent of these bills. We broadly welcome the context of where these measures are to apply, and consider strongly that these measures constitute much needed consumer protection. However, we have long supported the provision of consumer-friendly measures such as these to all investors, not just retail clients. Whilst we are aware that the focus of the broader reforms is on providing a higher standard of consumer protection to retail clients, we are aware of no concrete reasons why arbitrary reasons such as larger sums of money should be a barrier to proper consumer protection.

AIST supports the focus of these bills on the individual providing the advice, as well as on the licensee or authorised representative. We are aware of the limitations that applied to the industry in the past and agree that this will facilitate the aim of applying penalties to individuals where necessary.

AIST welcomes the inclusion of the proposed subsection 961(6) that expressly takes into account the use of an application that could feasibly provide an investor with personal advice. Whilst we continue to maintain that a computer program, whether provided over the internet or otherwise, could never provide the same quality of service as a natural person, we support the aims of services provided by licensees whereby scaled advice might be provided by such a facility.

2 Corporations Amendment (Future of Financial Advice) Bill 2011

2.1 Ongoing fee arrangements and disclosure

2.1.1 Section 962: Application of this division (Division 3)/section 962A: Ongoing fee arrangements

We note that in the proposed section 962, the proposed Division 3 is only to apply to ongoing fee arrangements which have not terminated for any reason. However, proposed section 962A clarifies that ongoing fee arrangements are only to apply where personal financial advice is provided to a person as a retail client.

This means that licensees will only need to comply with the legislation for "new" clients. Essentially, this allows for all current clients who are paying commissions to financial advisers and receiving no advice, to remain doing so. Further, even if they re-engage with their adviser there is no requirement for the licensee to provide a renewal notice as they will still not be considered as "new" clients. This does not seem a dramatic change from the status quo and not a great leap forward for the industry.

Ideally we would like to see these provisions set for all clients. However, understanding that commissions form a substantial part of current financial planning business' revenue and cash flow, we would propose that if the legislation is to only be effective for "new" clients, then a transition period should be set (say five years) where commissions can continue. After this period, all clients would be covered under the legislative requirements, regardless of when they became a client. This would be consistent with the spirit of the MySuper initiative underpinning Stronger Super.

2.1.2 Additional note regarding fee descriptions in proposed section 962A

AIST suggests that the word 'fee' be defined in the proposed section 960 to ensure that commissions (e.g. trail commissions and entry fee commissions on superannuation guarantee amounts) are also captured within this definition. This will avoid the exploitation of loopholes where one payment is disguised as another.

2.1.3 Section 962F: Client not liable to pay fee if this Division not complied with

AIST would like to see the proposed section 962F(1) extended so that if a fee recipient on-sells their client-base then the purchaser must contact all clients purchased with a renewal notice. It is often these clients (usually classed as C or D class clients) which form the passive income of fee recipients. Clients are routinely unaware of who their new adviser is in this situation.

2.1.4 Section 962H: Fee disclosure statements

AIST believes that fee disclosure statements and renewal notices should be de-coupled and at the very least the fee disclosure statement should be provided to every client who is being charged an ongoing fee or commission.

Further we would support ASIC-provided guidance on what the fee disclosure statement should look like and how the charges should be expressed as it is well established that a significant number of Australians are innumerate or are unable to understand percentage-based calculations. ASIC could also provide standard performance projection figures based on risk profile for the anticipated fees as many clients do not understand that fees are most often based on the quantum invested and increase as the quantum increases through contributions or investment performance. The statement should also include information on how the client can cease the payments and that it is their right to do so. Naturally, the statement should include the risks in doing so and the fact that doing so will mean the adviser is not obliged to provide advice.

2.2 Enhancements to ASIC's licensing and banning powers

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.

Further, we support ASIC increasing its auditing capabilities of AFS licensees on the premise that these audits are based on improvement of the quality and appropriateness of advice to individuals. In the recently released *ASIC Report 251: Review of financial advice industry practice* which obtained information from the top 20 licensees, an area of concern was around advice audits (paragraph 21):

> *"All participating licensees conducted some advice audits to examine the appropriateness of advice. One area of concern emerged where licensees did not select files for reviews at random (including within a risk-driven approach). We also saw evidence of some licensees notifying their advisers of the files to be reviewed prior to the audit taking place."*

With the promotion of scaled advice to improve access to advice, we believe that it is vital that ASIC works with industry to improve the take up of scaled advice, but also has the power to protect investors should an advisor or licensee abuse their privileges to provide this advice.

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

3.1 Best interests duty

3.1.1 Section 961B: Provider must act in the best interests of the client

AIST supports increasing the reach of financial advice to more Australians. We know that the increase in advice delivery to clients is a major goal of the reforms and we believe that the legislation should highlight the fact that advisers should take note of the most appropriate type of advice that will deliver the right outcome for the client. The proposed section 961B(2) identifies a good portion of what may be required, however this will not be the case in all instances.

AIST supports the creation of the best interests duty and agrees that the proposed section 961B is a vital step in the right direction. However, although we agree and support the intent of the proposed section 961B, we would have preferred that this duty was worded less prescriptively and that a principles-based approach was taken. Section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* – the obligation for superannuation trustees to act in the best interests of super fund members – illustrates that such an approach is not only possible, but successful.

3.1.2 Section 961G: Resulting advice must be appropriate to client

It is the view of AIST that the 'reasonable basis for advice' provisions that are presently contained at section 945A of the Act are a better fit within this section, rather than within the proposed subsection 961B(2). The reasons that we consider this to be the case is because we believe that the 'best interest' provisions to be contained within a principles-based section 961B refer to an overall duty, however the 'reasonable basis' provisions represent a standard of care. We believe that these sit side by side of each other and cannot be combined.

3.1.3 Section 961H: Resulting advice still based on incomplete or inaccurate information

Similar to section 961G, we are unsure as to inclusion of this subsection as we believe that this ought to be covered in a principles-based section 961B. Further, if a provider felt that they had incomplete or inaccurate information then they should decline to give advice until sufficient information has been gathered.

We would also like to point out that there are different opinions that exist as to when items of information are considered to be incomplete and/or inaccurate and propose that a measure of materiality be included somewhere in this division.

3.2 Conflicted remuneration and other banned remuneration

3.2.1 Subsection 963C: The professional development exemption

AIST supports the exemption proposed at subsection 963C(c), where benefits with a genuine education or training purpose that is relevant to providing financial advice and compliant with the Regulations are not considered to be conflicted remuneration. We also agree with most of the planned restrictions on this exemption, including the proposed majority time requirement and the proposed expenses requirement that are cited in the second and third dot points of paragraph 2.33 of the EM.

However, to require that professional development must be provided in Australia or New Zealand precludes licensees or their representatives from learning about best practice and new developments in the global financial services industry. (First dot point, paragraph 2.33, the EM):

Example

Trang is an adviser with and representative of the Widget Industry Superannuation Trust (WIST), an AFS and RSE licensee. Trang provides a personal advice service to WIST's members, and only has the WIST product on her approved product list.

WIST would like to pay for and send Trang to a conference in the USA on new financial advice technologies and associated member services only available in the USA. However, after reading the Regulations, they realise that, unless the conference is held in Australia or New Zealand, such a conference may be considered to be conflicted remuneration. They are unable to send Trang or any of their advisers.

3.2.2 Subdivision C of Division 4 of Part 7.7A: Ban on conflicted remuneration and the 'licensee loophole'

AIST supports the bans contained in this subdivision on receipt of conflicted remuneration by licensees and representatives (including authorised representatives) however, we continue to have concerns regarding the fairness of the provisions, and the way that this information is being communicated.

We draw your attention to paragraph 2.7 of the EM and the statement that the Bill defines 'conflicted remuneration' and bans 'its receipt and payment in certain circumstances'.

Proposed bans on receipt notwithstanding, we identified in our original submission to Treasury that payments are only banned from being made when they flow from employer to employee, from licensee to authorised representative and from product issuers to licensees or representatives. Licensees who are not product issuers or sellers will still be able to pay conflicted remuneration (the 'licensee loophole') and this opens the way for artificial structuring of remuneration arrangements where an entity is interposed.

AIST supports the new paradigm where financial advice is "the product", rather than financial products that are recommended to support the advice. We are concerned that this sort of careful wording is at odds to the original findings of the Ripoll report, and we believe it creates a way of continuing the present situation, where advice can be potentially compromised by inappropriate remuneration arrangements.

3.2.3 Section 964A: Platform operator must not accept volume-based shelf-space fees

Lastly, we note that it is proposed that platform operators must not accept shelf-space fees, however there is no ban on the *payment* of such amounts. For the same reasons as we considered above, we consider that there should be a ban on licensees paying shelf-space fees in the interests of fairness.

3.2.4 Subsection 964A(3)(b): The scale discount exemption

AIST supports genuine scale-based discounts or rebates that are provided in accordance with the proposed subsection 964A(3)(b) being passed on to customers in all instances. Doing otherwise raises questions about the nature and transparency of such arrangements.

We also consider that the criterion of 'efficiencies' as described in this subsection is vaguely defined and open to abuse and that this term must be tightly defined in this Bill, or in the Regulations.

4 For both bills

4.1 Transition

AIST supports the proposed timetable in the bills, particularly in light of the recent announcement from ASIC where they announced that they will adopt a facilitative compliance approach for the first 12 months of the implementation of the FoFA reforms, until 1 July 2013.[1] We believe that any further extension of the implementation time will allow licensees to avoid their duties and quarantine clients into 'grandfathered' arrangements.

4.2 Additional provisions

AIST supports all remaining provisions in the bills.

[1] ASIC, 13 December 2011, http://tinyurl.com/6qzdjp9 .