Association of
Financial Advisers

Response:

PJC – Proposed FoFA Reforms

Submission to Parliamentary Joint Committee
on Corporations and Financial Services.

22 December, 2011

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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

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Dear Mr Ripoll,

PJC Inquiry – Corporations Amendment (Future of Financial Advice) Bill 2011

The Association of Financial Advisers Limited ("**AFA**") has been serving the financial advising industry for over 65 years. Its aim is to provide members with a robust united voice, continually improve practices and focus firmly on the exciting, dynamic future of the financial advising industry.

With over six and half decades of success behind it, the AFA's ongoing relevance is due to its philosophy of being an association of advisers run by advisers. This means advisers set the agenda, decide which issues to tackle and shape the organisation's strategic plan.

The AFA thanks the PJC for the opportunity to provide a submission on the Future of Financial Advice Bill 2011 and Further Future of Financial Advice Measures Bill 2011 ("FoFA Bills").

The AFA supports the Government's objective to see more Australians access financial advice, which is in keeping with the policy intent of the Future of Financial Advice Reforms. However, a number of the components of FoFA will create a very different outcome. These will be discussed in greater detail in this submission.

This submission has been prepared by the AFA on behalf of its members and in response to the FoFA Tranche 1 and 2 Bills. This submission provides comments and recommendations on the following:

1. Overall strategic intent and the focus and purpose of FoFA
2. FoFA Bill Tranche 1
3. FoFA Bill Tranche 2

Our submission aims to provide you with an overview of what we consider to be the main issues concerning our members, contained within the FoFA Bills.

Should you have any questions, please do not hesitate to contact me on either (02) 9267 4003 or 0412 127 834.

Yours sincerely

Richard Klipin

Chief Executive Officer
Association of Financial Advisers Ltd

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Executive Summary and Introduction

The AFA has been involved in the PJC process since the inquiry was launched in early 2009. The AFA supported the process and intent of the inquiry from the outset.

Indeed our Media release Headline on 3 March 2009 was:

"AFA welcomes the Parliamentary Inquiry into Financial Products and Services in Australia"

Once the process commenced, the AFA was very involved in working with members of the PJC to ensure that the members understood the role of financial advisers and the nature of the client/adviser relationship. AFA members spent many hours across the country with MPs and members of the PJC. The final report was welcomed by the AFA with our headline of 23 November 2009:

> **"AFA Response to Recommendations from the Ripoll Inquiry - The Rubicon has been Crossed"**
>
> **Sydney: 23 November, 2009** - The Association of Financial Advisers (AFA) welcomes the dawn of a new era in financial advice, with the handing down tonight of recommendations from the Parliamentary Joint Committee on Corporations and Financial Services (the Ripoll Inquiry).
>
> AFA National President, Jim Taggart, said the recommendations represent an important step forward in the journey towards making the financial advice industry one of Australia's most trusted professions.
>
> "The Committee has recognised the complexities of our industry and addressed all the major issues," he said. "The Rubicon has been crossed."

November 2011 - Two years on

Unfortunately, we are now a full two years on from the release of the PJC report, and the eventual outcome of FoFA still remains unclear. When put in the context of the huge impact that the GFC has had on advisers (and their clients), this now reflects a period of nearly 4 years where advisers have been subjected to huge environmental and regulatory uncertainty.

Growth strategy for the Industry or Decimation of Financial Advisers?

As FoFA has continued to drift over the last 12 – 18 months and as the goal posts have continued to shift (discussed further below), the level of trust in the market place has progressively declined.

The release of predictions of a significant reduction in adviser numbers, contained in the Explanatory Memorandums (EM) to both Tranche 1 and 2, only serves to highlight the level of anxiety and uncertainty being experienced. If the reduction of over 40% of advisers, as suggested in the EM, were to eventuate, this would decimate this particularly important industry. Such an outcome would result in a significant reduction in the number of consumers receiving advice, which would have seriously detrimental impacts upon the country as a whole.

In addition, advisers run small businesses, employ staff and inject business into their local communities and economies. The downstream impact of a reduction of 6,800 advisers has a multiplier effect of at least five given the staff the average practice employs and other related suppliers.

AFA Media release 14 October 2011:

> "AFA: GOVERNMENT'S FOFA LEGISLATION DECIMATES SMALL BUSINESS ADVISERS FAILS CONSUMERS"
>
> **Sydney: 14 October 2011** - *The Future of Financial Advice Bill (the FoFA Bill) introduced into Parliament yesterday by the Minister for Financial Services and Superannuation, Bill Shorten, will, according to Rice Warner Research cited in the Explanatory Memorandum (EM), almost halve the number of advisers operating in the industry by 2024, cut adviser revenue by $2.5 billion and change the fundamental characteristics of people providing advice to everyday Australians.*

Executive Summary and Introduction (cont).

FoFA Losing Direction?

A clear indication of the extent to which FoFA has lost direction is apparent from the Tranche 1 Bill that was introduced into parliament on 13 October 2011. This bill was limited to Opt-In, which was never part of the PJC recommendations, and an increase in ASIC powers. Thus of the 11 PJC recommendations and the seven key FoFA recommendations from April 2010, only a small fraction appeared in the first FoFA Bill.

The policy changes on the FoFA journey include:

- Introduction, then partial removal, of a ban on insurance commissions inside super.
- Opt-in every year, then two years.
- Introduction and potential removal of Annual Fee Disclosure statements for existing clients.
- FoFA in two tranches, not one comprehensive package.

Other key issues include:

- Breaching of the Office of Best Practice Regulation requirements.
- FoFA - no modelling or consequence analysis?

There has been no explanation provided as to why FoFA has been split into separate Tranches. Once again, this serves to undermine the faith in the process.

With respect to the increase in ASIC powers, the AFA supports this proposal, provided there is clarity with respect to the circumstances under which these powers can be employed, and controls around the application of these powers.

Consumers: the missing piece and the real issue

The focus of FoFA has become mired in a range of technical issues and the debate needs to be re-centered on the key issues facing consumers. That is:

- How do we ensure more people seek advice?
- How do we ensure that the advice provided is transparent, robust and in the best interests of the clients?

At the same time we need to ensure:

- We maintain a robust and competitive market place.
- A balance between regulatory levers, industry best practice and market competition.

Good financial advice transforms lives and helps consumers make good decisions about the key issues in their lives. With only 20% of Australians getting advice, we have a major task to undertake. When we look across the Australian community we see big issues regarding:

1. Too much debt.
2. Not enough savings.
3. Not enough or inadequate levels of insurance.
4. Inadequate levels of financial literacy.

The role and benefits of advice

Financial advice is about addressing three key areas:

- Living too long (Creating wealth, super planning, retirement planning)
- Dying too young (Comprehensive risk management and insurance)
- Becoming sick or ill or suffering an accident (part of managing risks in daily life)

In essence, the AFA's view is that advisers need to build, manage and protect the wealth of their clients.

Executive Summary and Introduction (cont).

The AFA in 2010 commissioned key research, "Back to Basics" to evidence the underlying value to consumers of working with financial advisers. The findings were a timely reminder.

The media release at the time discussed this in detail:

> "BACK TO BASICS: GROUNDBREAKING RESEARCH INTO CONSUMER ATTITUDES TOWARDS FINANCIAL ADVISERS REVEALS GOVERNMENT HAS MISREAD THE ISSUES"
>
> **Sydney: 14 July 2010** - *Consumers with financial advisers understand the role of their adviser, trust them, highly value the advice they are given and are happy to pay for it - be it via a fee or via commissions. These consumers are happier with their investments and have greater peace of mind than those who are trying to navigate the complex world of investment and insurance without the help of a financial adviser.*
>
> *These are the central findings of groundbreaking new research into consumer attitudes towards financial advice, commissioned by the Association of Financial Advisers (AFA) and conducted by leading market intelligence and research consultancy, brand management.*
>
> *"The research findings very clearly demonstrate that consumers who have an advice relationship are better planned and happier with their investments than those who don't," AFA CEO Richard Klipin said. "Consumers with advisers rank them the third most trusted professional, after medical specialists and dentists. They look on their adviser as a coach helping them along the path to financial freedom and therefore have greater peace of mind."*

The financial advice industry is a particularly important industry. The AFA firmly asserts that the provision of financial advice is good for consumers and for Australia as a whole. Consumers who receive financial advice are better off, both financially and emotionally. However with only 20% of the community seeking advice, there is a need to ensure that more Australians seek advice. The benefits to the country are clear for consumers, the Government, the economy and the market place. In these current times of significant fiscal pressure, these benefits are critical to the health of the Australian Federal Government Budget.

The AFA is committed to ensuring that FoFA delivers strong outcomes across the value chain and for consumers in particular.

From the Ripoll Report to FoFA – From Bipartisan Agreement to Disunity

The PJC inquiry, which was launched in February 2009, and reported in November 2009, was formed largely in response to a number of high profile collapses such as Storm and Opes Prime. The inquiry was wide ranging and received a large number of submissions and involved a lengthy period of public hearings. The 11 recommendations from the Ripoll Inquiry are included in Appendix 1.

There was broad Industry support for the Ripoll Inquiry findings. However in the two years since the Report was tabled, the industry and the AFA have been concerned by:

1. The process; and
2. Policy (Legislation outcomes).

Process Concerns:

1. Good policy comes from good process and whilst the consultation process run by Treasury initially started very well, in recent times it seems like the outcomes have been rushed through following a predetermined outcome rather than seeking the most cohesive outcome.
2. Good policy comes from good research and no independent research has been commissioned to support or refute the FoFA outcomes.
3. FoFA has breached the Office of Best Practice Regulation requirements. This is a clear indication of rushed policy that misses key issues and will create substantial issues in implementation
4. Consequence analysis: FoFA will decimate the retail financial advice industry (based on the Governments data in the EM). More than this, each adviser job lost will result in at least a further five jobs lost in the towns and cities across the country.

Policy Concerns:

1. Opt-In – The Opt-in and fee disclosure statement obligations will add three levels of costs: at the adviser to client level, the licensee level and the product manufacturer level. This will price advice out of the reach of many ordinary consumers.
2. Insurance Remuneration – the government has created confusion with different insurance remuneration arrangements for inside and outside superannuation. This confusion will ultimately affect the take-up of insurance in an already dramatically under-insured population.
3. Grandfathering – The FoFA changes should be prospective and should not impact upon existing commercial arrangements.
4. Best Interests duty – while the principle is sound, the AFA believes the devil will be in the detail. A best interests duty may also increase the cost of professional indemnity insurance.
5. Lots of devil in the detail – the legislation as it currently stands is complicated and confusing for both consumers and the advice profession.
6. Start date of July 2012 is unworkable – implementation will take a considerable investment of time, energy and money.
7. Projected cost of implementing the FoFA Changes. Across the industry, at the product provider, advice licensee and adviser level, the costs of implementing these changes and the ongoing management of these changes will be very high. The core elements of this package could be delivered in a much more cost effective manner.
8. Projected loss of jobs for 6,800 advisers (as noted in the Tranche 1 Explanatory Memorandum – 13 October 2011) + staff + clients + communities – the costs to small business advice practices of implementing changes associated with FoFA will force many out of business, resulting in tens of thousands of job losses. The market will be concentrated and consumers will have fewer choices in where they access personal advice, supported by a client-adviser relationship.
9. Regional communities are likely to lose service providers.

The process and policy concerns are addressed in the following two sections.

Process Concerns –
A Lack of Process, Governance and Implementation

Consultation and Legislative Development Process

Whilst the consultation process run by Treasury started well, it appears that prior agendas are taking precedence. This is highlighted by two key indicators:

- The history of changes and surprises.
- The splitting of FoFA into multiple tranches.

Changes and Inconsistency

The industry is uncomfortable with the way the proposed legislation has regularly changed at the last minute. This has meant that as some issues were progressed or resolved, new issues would be raised. The key changes have been as follows:

- Opt-in was never part of the PJC Recommendations, but was added to FoFA (April 2010).
- The ban on Commissions for Risk inside Super was specifically excluded in the April 2010 release, but was included in the April 2011 statement.
- The ban on Soft Dollar benefits was specifically excluded in the April 2010 release, but was included in the April 2011 statement.
- The ban on Risk inside Super was reduced to Group Life and Default Superannuation Funds (29 Aug 2011).
- The ban on payments from Fund Managers to platform operators was only added as part of the draft Tranche 2 legislation (28 Sept 2011).
- Fee Disclosure Statements for existing clients was only added when the legislation was introduced to parliament (13 Oct 2011), despite an extended consultation process and commitments with respect to no retrospectivity.

Breaking FoFA into Multiple Tranches

FoFA has always been discussed as a package of reforms, yet we have already seen it broken into 2 tranches and can also expect further legislation on related matters. It is particularly concerning to need to separately assess different tranches as there are close interdependencies between different elements of the FoFA package.

There is a level of concern within the industry with respect to the reasons for why FoFA has been broken into multiple Tranches and the lack of explanation for this. Breaking FoFA up into multiple tranches is poor practice. The industry should be given the chance to review the legislation in its entirety, not in bits and pieces.

Lack of Research, Investigation and Modelling:

Minister Shorten in his speech to parliament on 13 October 2011, stated "These measures which I refer to constitute a growth strategy for the financial planning and advice industry", yet in the Explanatory Memorandum introduced into parliament on that same day, there is a reference to a prediction of adviser numbers declining from 15,400 to 8,600. The comment about FoFA being a growth strategy, was one that the minister made separately in his media release on 29 August 2011, when releasing the draft legislation. It is necessary to question, the consistency between the comment about a growth strategy for financial advisers, with the inclusion of predictions in the EM of a 6,800 reduction in adviser numbers, representing 44% of all advisers.

The prediction of a reduction of 6,800 advisers comes from a report prepared by Rice Warner on behalf of the ISN in March 2010. Thus it is important to note three key things – this report was produced before the announcement of FoFA, was commissioned by a group who could not be considered to be independent, and did not allow for the potential impact of Opt-In.

Process Concerns –
A Lack of Process, Governance and Implementation (cont).

It is surprising and disturbing that Treasury have done no independent assessment of the impact of FoFA on the Financial Advice industry (or at least not released it), particularly in the circumstances where one piece of research (from Rice Warner) suggests that the impact would be a virtual decimation of the industry as we currently know it.

Importantly, with reference to international standards, it would be relevant to know if an Opt-In model is being employed in any other jurisdiction.

Office of Best Practice Regulation

A review of the FoFA page on the Office of Best Practice Regulation website, includes the following coverage:

"An adequate Regulation Impact Statement (RIS) was prepared on the broad ban on volume based payments from product issuers to financial advisers under the previous best practice regulation guidelines and is required to be published upon tabling of the regulations. RISs were prepared for the various other reforms but were not assessed as adequate for the decision-making stage. Consequently, the OBPR has assessed the proposal as being non-compliant with the Australian Government's best practice regulation requirements.

A post-implementation review will be required within 1 to 2 years of its implementation."

This situation is clearly inadequate. The FoFA legislation has been assessed by the Office of Best Practice Regulation (part of Treasury) as being non-compliant. Unfortunately there is no further detail on this, which is most concerning, and an important issue where an explanation from the Government is required. This process is an important control in ensuring that legislation is appropriate and well balanced. In many ways this is ironic – a lack of transparency on the reasons for non-compliance by a piece of legislation designed to address a perceived lack of transparency in the financial advice industry.

It is necessary to point out that the RIS on the broad ban on volume based payments from product issuers to financial advisers has not been released, despite the tabling of the Tranche 2 legislation.

It would also be entirely unsatisfactory to wait for one to two years after implementation, in the hope that a post implementation review would highlight the issues that are already evident with respect to the extent that some of FoFA is poor policy.

Policy Outcome Concerns

The AFA view is that the Ripoll recommendations have not been delivered by the FoFA package and that the good intents have been diverted by sectional interests (ISN in particular). FoFA has been used to pursue an agenda in support of one section of the market place, at the expense of consumers and advisers.

Opt-In – Simply Bad Policy

At the core of the Ripoll Inquiry was the issue of adviser remuneration and concerns about the conflict of interest between the adviser and client. To address this, the Ripoll Inquiry made two key recommendations:

- The implementation of a fiduciary duty or best interests obligation on the adviser, where the interests of the client would need to be placed in front of the interests of the adviser.
- Development of a mechanism to cease payments from financial product manufacturers to financial advisers.

When the Government announced FoFA in April 2010, the proposal included a best interests obligation and a ban on commissions for investments and superannuation. The Government, however went one big step further, by proposing an annual Opt-In obligation. It can be argued that the introduction of the best interests obligation and the ban on commissions specifically address the original grounds for concern and make an Opt-In requirement unnecessary. Opt-In was never addressed as part of the Ripoll Inquiry, and only seems to have come up in the Industry Superannuation Network (ISN) media releases just prior to the April 2010 release of FoFA.

The grounds for rejecting Opt-In are strong:

- Best Interests and the Ban on Commissions already address the issue.
- Opt-out is available to clients at any time, and in a legislative form would be supported by the industry.
- All research on human nature and responding to an Opt-In type requirement, suggests that response rates are likely to be low. No independent research has been undertaken to assess the likely outcome or the net impact of this requirement with respect to the interests of consumers. It is quite likely however, that simply getting client responses will take significant chasing, unless the Opt-In is undertaken in a face to face meeting, at the time of a review. This won't always be possible. It is inevitable that Opt-In would lead to a high number of clients unintentionally being disconnected from their advisers.
- Opt-In is a huge administrative exercise and one which would be costly for advisers and thus would add to the cost for consumers.
- In the context of the fundamental value to clients from financial advice, steps that reduce the access to and utilization of advice are counter-productive.

Thus it is clear that Opt-In became one step too far, and was a big trigger in terms of the loss of alignment between the Government and the Industry. This was clearly the first step in terms of a loss of faith in the reform process, and led to the commencement of a very active lobbying campaign by the financial advice industry.

Policy Outcome Concerns (cont).

Insurance remuneration - A Ban on Commissions for Risk Insurance Inside Superannuation

The arguments for a ban on commissions on insurance have not been anywhere near sufficient to gain broad support. In fact there are many strong arguments for why commission should continue on risk insurance products. Many of these arguments were covered in the Ripoll Inquiry. The key difference between Investments/Superannuation and Risk is that commission free investment and superannuation products already exist, and have in fact been readily available for clients with larger investable amounts for a number of years. Risk Insurance is a very different product set (similar in many ways to general insurance type products), has an annual renewal period, and a defined benefit or risk addressed. Thus the AFA has argued that risk should remain outside the FoFA remuneration changes. The Government took a similar position in their April 2010 announcement.

In the Government's media release of April 2011, they introduced a proposed ban on commissions for insurance inside superannuation, with effect from 1 July 2013. This was directly inconsistent with the announcement from 12 months earlier, and came as a complete surprise to the industry. It also introduced major issues with inconsistency between the two insurance environments – inside super and outside super (ordinary).

Thus another step was taken by the Government that had a potentially huge impact on the industry. Once again, a change in policy by the Government, resulted in significant disquiet within the industry and created the grounds for increased lobbying and resistance to the government agenda.

It also needs to be noted that the ban on insurance inside super was a point supported by the ISN, and thus this action by the Government appeared to be a further step of the Government acting in the interests of the ISN, and to the disadvantage of the retail financial advice industry.

In terms of a level playing field and consistency with the FoFA objectives, it is necessary to point out that FoFA does not prevent superannuation trustees from receiving commissions for group life insurance arrangements.

Change of Plan on Insurance Inside Super

On 29 August 2011, when the Government released the draft Tranche 1 Bill, they changed the policy position on Risk Insurance inside superannuation. Now the ban was going to be limited to group life only and insurance for default superannuation funds. Whilst this was a positive change, as it removed the ban on retail advised superannuation insurance, it still left the issue of advised group insurance arrangements, where commissions were to be banned.

The AFA recommends that this area be the subject of greater research and investigation. In the context of corporate superannuation and group life insurance, there needs to be a comprehensive review of the current model across retail, corporate and industry fund superannuation plans. Consideration needs to be given to a sensible alternative remuneration model for insurance arrangements, where advice is provided.

Thus this represented another change of plan on the application of a ban on commissions for insurance inside superannuation. There was no explanation of this change other than the feedback from the industry.

Commencement Date for Insurance Inside Super

When the draft FoFA Tranche 2 Bill was released on 28 September 2011, there was no mention of the 1 July 2013 commencement date for the ban on commissions for Group Life and Default Fund insurance arrangements. This was another case of the legislation process driving uncertainty and anxiety for the industry. The draft Tranche 2 legislation also failed to address the application of broader grandfathering arrangements. As FoFA has been split into multiple Tranches, trust is critical to ensure that all that is promised is delivered. When FoFA is split up and certain things are left out, trust is seriously impacted.

Within the Tranche 2 EM there is commentary to suggest that the 1 July 2013 start date for the ban on commissions for insurance inside super, will be addressed through the regulations. The AFA does not support this and strongly recommends that key elements of FoFA are addressed through the legislation.

Policy Outcome Concerns (cont).

Grandfathering – Lack of Consistency and Certainty

Whilst the commitments on grandfathering are clear – no retrospectivity, what has been proposed and delivered is different. The current proposals are either inconsistent with this commitment or are unclear.

Annual Disclosure

When the FoFA Tranche 1 Bill was introduced into parliament on 13 October 2011, the Fee Disclosure Statement obligation was extended to existing clients. This was significantly different from what was contained in the draft bill released on 29 August 2011, and the commitment from the government throughout this process that there will be no retrospectivity. The requirement to provide fee disclosure statements to existing clients would have huge implications, including coverage of legacy products and systems, and would be effective immediately from 1 July 2012. A change this significant, at the end of the consultation process, without any warning, at the time the legislation is introduced into parliament, is a total breach of faith and trust. This came on the same day that the EM was released that included a prediction of a significant decline in adviser numbers.

Transitional Arrangements - Ban on Commissions and Volume Bonuses

The government commitment has always been that there will be no retrospectivity, and that grandfathering arrangements will be built into the legislation. With the release of the Tranche 2 legislation on Thursday 24 November, the bill included transitional arrangements that left out the bulk of existing commission and volume bonus arrangements (via exclusion of platform operators) and provided sweeping powers via regulations to what might be impacted and what might not. The AFA view is that this lack of certainty is unacceptable and that the legislation should clearly set out that any pre-commencement arrangement is exempt from the prohibition on conflicted remuneration. The AFA does not support the allocation of powers to the Minister to make key decisions of this nature without reference to the parliament.

Best Interests and the Devil in the Detail

The AFA has supported the proposal of a best interest duty, provided it could be made practical and would not lead to uncertainty and a litigious environment. What has been delivered in Tranche 2, goes some way to addressing the concerns with the draft version that was released in late August. There is some concern around the market with respect to the impact of this best interest proposal, in particular to the lack of a clear definition on best interests, likely impact upon Professional Indemnity Insurance and risk of client litigation. In the context of this concern, the AFA believes that there is a need for further consultation and consideration on the best interests legislation. As with legislation of this nature, there will always be devil in the detail with unintended consequences. We believe that best interests poses a significant risk for unintended consequences.

The AFA strongly supports initiatives to make scalable advice more cost effective to provide to clients who have specific financial planning needs. We are concerned that the Best Interests legislation will make it more difficult to provide scalable advice, not easier. This outcome would be contrary to one of the core objectives of FoFA, which is to make advice more accessible. The initiatives to support scalable advice are currently missing from the two FoFA Tranches.

Policy Outcome Concerns (cont).

Commencement Date

The AFA asserts that the FoFA process has run off its natural tracks through a government that has frequently changed the plan and been willing to pursue poor policy in the apparent support of particular interest groups. If FoFA had been followed in a properly consultative way, the issues could have been resolved and legislation passed in order for a genuine 1 July 2012 commencement. As it is, we are now in a position of high uncertainty with no likelihood of a resolution within a timeframe that would allow all the necessary changes to be made. A start date prior to 1 July 2013 is no longer practical.

Implementation and Ongoing Costs

Through discussions with a number of financial services businesses, it is clear that implementing the FoFA changes is going to be extremely expensive. The costs will be borne at the product provider, advice licensee and adviser level. Proposals such as Opt-In and fee disclosure statements have implications at each of these levels. Across the industry, the cost of implementation will run into the hundreds of millions of dollars. It is necessary for Treasury to understand the likely cost of each element to ensure that the benefits of the change justify the costs.

Uncertainty Concerns

Throughout the legislative review process, the AFA has been concerned about the lack of certainty in the drafting. The most notable areas of concern include the following:

Sale of a Financial Advice Business or Book of Clients

Advisers are keen to understand the implications in terms of the grandfathering arrangement in the case of the sale of a business or a book of clients. In this context, we refer to the Opt-In obligation and the ban on commissions. This is an issue that is likely to have a material impact on the value of a business. The legislation provides no certainty. Paragraph 1.59 in the EM to Tranche 1 even suggests that these business transitions will need to be determined on a "case by case" basis. For such an important point, this lack of certainty is very concerning.

Grandfathering

As mentioned previously, there is a lack of clarity on the application of grandfathering and how this will apply in terms of Opt-In, fee disclosure statements, volume bonuses and volume based shelf-space fees. In the Ministers media release of 29 August 2011, he said:

> *"Following legal advice from the Australian Government Solicitor, the Government has determined that the ban on conflicted remuneration (including the ban on commissions) will not apply to existing contractual rights of an adviser to receive ongoing product commissions.*
>
> *This means that, in relation to trail commissions on individual products or accounts, any existing contract where the adviser has a right to receive a trail commission will continue after 1 July 2012, or in the case of certain risk insurance policies in superannuation, 1 July 2013. This means that trail commissions will continue to be paid in these circumstances.*
>
> *However, it is proposed that the ban on conflicted remuneration (including volume payments) would have some application to existing trail arrangements from platform operators to licensees or dealer groups. The reforms will prohibit future payments to licensees (or their representatives) in respect of new investments through a platform, but will grandfather future payments to licensees (or their representatives) in respect of investments in a platform accumulated prior to 1 July 2012. In short, this means that the level of volume payments from platform providers to dealer groups will 'crystallise', and should not increase in size after the commencement of the reforms on 1 July 2012.*
>
> *In relation to the ongoing fee (or 'opt-in') arrangements, this measure will apply prospectively to new arrangements with new clients entered into after 1 July 2012. This means that opt-in will not apply at all to existing clients."*

The reference to crystallisation of volume payments from platform providers to dealer groups is most unclear. This has never been explained and the Tranche 2 EM now appears to suggest that this will be addressed through regulations. It is not possible for businesses to plan and make key decisions in an environment where there is a complete lack of certainty.

Remuneration of Employees

Section 963J prohibits an employer from giving employees conflicted remuneration. This seems to apply to direct employees of the Licensee (or representatives), rather than employees of an authorised representative. The application to an authorised representatives business is unclear. This requirement alone will have a huge impact upon employee contracts within salaried businesses. The important issue behind this is the possible prohibition of incentive arrangements that are designed to encourage a salaried adviser to maximise the amount of advice that they provide to their clients. FoFA should not be driving an outcome that will remove appropriately balanced employee incentives.

Uncertainty Concerns (cont).

Overseas Professional Development Events

The Tranche 2 EM includes a section that suggests that overseas conferences will be banned. There is no distinction provided between product provider conferences and licensee events. In the context of a licensee holding a conference overseas, for their own advisers, this seems an unnecessary restriction. Overseas venues in the Asia Pacific region possess a set of positive attributes that can be accessed at a competitive price. In terms of conflicted remuneration, where it is a licensee event, there is no meaningful difference between a domestic or an Asia Pacific conference. As many licensees have already booked overseas events for the period post 1 July 2012, this proposal is adding significant uncertainty to these entities.

Asset-based Fees on Borrowed Amounts

Whilst we appreciate the rationale behind the ban on asset-based fees on borrowed amounts, this proposal does have significant complexity implications that have not been clarified. Whilst the transition arrangements detailed in Section 1531, provide some guidance, this is still not sufficient to address many of the potential circumstances that an adviser may find themselves facing, when dealing with a client who is investing with borrowed funds.

Uncertainty Implications

The points raised above are a selective sample of cases where there is a high level of uncertainty with respect to the obligations imposed by the FoFA legislation. The AFA expresses the view that it is unreasonable to have this level of uncertainty, a matter of only 6 months from the proposed commencement date. The uncertainty is problematic for business planning, practice values, business efficiency and adviser anxiety.

There needs to be a consultation and communication program to address this high level of uncertainty.

Impact and Consequences of FoFA

As mentioned above, one of our key concerns with the FoFA process, is the lack of independent research that has been done to assess the likely impact and consequences of the legislation. Of the research that is referred to in the EM, we hold deep concerns.

The Impact of a 6,800 Reduction in Adviser Numbers

As stated above, in March 2010 research undertaken for the ISN by Rice Warner predicted that the number of full service advisers would decline from 15,400 to 8,600 by 2024 – a decline of 6,800 or 44%. The Rice Warner research also predicts a 47% reduction in adviser revenue, relative to the situation where there was no regulatory change.

Whilst a 6,800 decline in advisers is a very significant impact, there is a multiplier effect that needs to be considered. Within any average adviser practice, there is likely to be two to three support staff for each adviser. There will also be further jobs lost with respect to support service providers such as accounting, legal, IT, Tax etc. In addition, within the financial services industry there are a number of staff who support advisers and thus the jobs in this area would also decline. It would be reasonable to expect a direct multiplier of at least five times. This would mean a reduction of at least 34,000 direct roles, based upon current resourcing levels. It is difficult to see how this could be described as a growth strategy. It is also likely that there would be a significant indirect impact, where there is a flow-on effect to other small businesses. This is expected to be most pronounced in rural communities.

It is also necessary to do further analysis in terms of the impact of a reduction in adviser numbers on consumers. If, on average, each of these advisers had 250 clients, then this would mean that a further 1.7 million consumers would no longer be advised. If we used an average of 400 clients per adviser, this number would increase to 2.7 million consumers who were no longer advised.

Market Consolidation

The financial advice industry has been subject to consolidation in recent years. This consolidation has ramped up recently, which is illustrated by the recent activity with respect to the acquisition of Count by the CBA Group.

It is expected that we will see further consolidation of the financial advice industry. Many commentators have questioned whether this consolidation is in the best interests of consumers, as the proportion of advisers who are not aligned to a major group, continues to decline.

Whilst much of the focus has been on the larger unaligned licensees, it is expected that the smaller non-aligned licensees will also be seeking mergers that provide greater security.

Recommendations and Next Steps

We accept the need for legislative change, and remain committed, in large part, to the Ripoll Inquiry recommendations. As covered above, we believe that the current legislation has a number of deficiencies that require resolution.

Accordingly we would like to recommend to the PJC that a range of steps are undertaken to address the current concerns about the FoFA process and policy:

1. Process outcomes.

a. That Treasury commission research and modeling of the FoFA initiatives with specific regard to:

i. Benefits to consumers

1. Impacts on demand
2. Impact on supply
3. Impact on cost
4. Impact on access
5. Impact on access in the regions

ii. Costs to industry

iii. Projected employment losses.

1. Advisers, adviser practices, licensees, product providers.

iv. Projected revenue loss to the ATO.

1. PAYG, BAS, Company tax
2. Projected revenue loss due to lower advice take-up.

v. Benefits to Industry.

1. New operating models.
2. New product opportunities.
3. Scaled advice.

vi. That this is benchmarked to other industries to ensure commercially sensible outcomes.

b. PJC recommend that the Government hold a Financial Services summit, with all key stakeholders, to set the broad strategic focus for financial services advice outcomes.

i. Key participants to agree on the key issues.

1. Lifting access to advice beyond 20%
2. Agreeing the key strategic initiatives.
3. Building a consensus for change.

Recommendations and Next Steps (cont).

2. Policy outcomes.

a. That Opt-in is removed from FoFA and is replaced by a strengthened Opt-out option.

b. That Commission for insurance products remain where advice is provided and are banned for MySuper style products only.

c. That annual fee disclosure is removed from FoFA.

d. That the Transition arrangements allow for a full exemption on all existing business and commercial agreements. FoFA should be applied prospectively only, with effect from the implementation date.

e. That the best Interests test is clear, concise and allows advisers, clients and licensees to clearly understand the limits of the duty.

f. ASIC powers, the AFA supports this proposal, provided there is clarity with respect to the circumstances under which these powers can be employed, and controls around the application of these powers.

g. Scaled advice introduced, together with appropriate safe guards, that create the same advice standards across all advisers.

3. The Government develop a real growth strategy for the profession.

- A package of initiatives designed to support the industry through what will be a challenging transition process, including.
  - Small business support.
  - Funding for consumer campaigns promoting the Value of Advice.
  - Tax deductible financial advice.
  - Restriction of the term financial adviser/ financial planner.

4. Delayed commencement date

In the context of the referral to the PJC and the Senate Economics Committee, it is now clear that the legislation cannot go back into the parliament for a number of months. This means that it is now impossible for the industry to be ready for a 1 July 2012 commencement. The AFA has previously voiced a view that the commencement date should be no less than 12 months after the date the legislation is passed. Based upon this principle, 1 July 2013, would be the soonest that the legislation could commence.

Accordingly we ask that the PJC specifically consider the most appropriate commencement date in the context of the work required across the industry in order to be ready to implement the required changes.

Appendix 1

Ripoll Inquiry Recommendations

The outcome of the Ripoll Inquiry, representing 11 recommendations was both bipartisan, and the subject of broad community and industry support. The recommendations were as follows:

1. That the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.
2. That the government ensure ASIC is appropriately resourced to perform effective risk-based surveillance of the advice provided by licensees ad their authorized representatives. ASIC should also conduct financial advice shadow shopping exercises annually.
3. That the Corporations Act be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest.
4. That the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers.
5. That the government consider the implications of making the cost of financial advice tax deductible for consumers as part of its response to the Treasury review into the tax system.
6. That section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry.
7. That, as part of their license conditions, ASIC require agribusiness MIS licensees to demonstrate they have sufficient working capital to meet current obligations.
8. That sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a license, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.
9. That ASIC immediately begin consultation with the financial services industry on the establishment of an independent, industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.
10. That the government investigate the costs and benefits of different models of a statutory last resort compensation fund for investors.
11. That ASIC develop and deliver more effective education activities targeted to groups in the community who are likely to be seeking financial advice for the first time.