Association of
Financial Advisers

Response:

PJC – Proposed FoFA Reforms

Supplementary Submission: Association of Financial Advisers Ltd

24 February, 2012

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

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Dear Mr Ripoll,

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

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") and to appear before the committee on 23 January 2012.

At the hearing, we were asked to provide further details with respect to the costs of complying with the Opt-In and Fee Disclosure Statement obligations, which are set out below. We have also taken this opportunity to provide the committee with some further input relevant to your considerations of the FoFA legislation.

Within this supplementary submission we have also provided some analysis of the recent Rice Warner report, that reflects upon the likely job losses and other key factors from that report.

Adviser Cost Related to Opt-In and Fee Disclosure Statements

At the PJC Hearing on 23 January 2012, after answering a question on the additional cost of the Opt-In and Fee Disclosure Statement obligations, our President, Mr Bradley Fox was asked by Senator Thistlewaite to provide further details to the committee. In preparing these calculations Mr Fox has provided the following information:

In assessing the costs, the following contributing factors have been allowed for:

- The time involved varies between the year when only the Fee Disclosure Statement (FDS) is required and the year when both the FDS and Opt-In are required.
- **Scheduling when FDS and Opt-In letters are required.** Advice businesses will need to have clear schedules of when letters are due, to ensure that the work commences at the correct point, that the letter goes out within the allowable timeframe and that responses are received as required. It is expected that this will necessitate an additional regular team meeting within the adviser's office.
- **Capture of Information on Fees and Commissions.** In a typical advice business, the information on adviser fees and commissions will be available on the fees report they receive on a regular basis from their licensee. In some cases fees may be paid on a fortnightly basis, whereas in other cases it will be monthly. In the event of a fortnightly payment cycle, the admin staff will need to identify every occurrence of that client and collect the data off the 26 statements. As clients often have multiple product holdings across different product providers or even the same product provider, these typically result in separate records (i.e. the name expressed differently – John Smith, John P Smith, JP Smith etc). This information will need to be gathered in a format that can be subsequently checked to confirm accuracy. Since the reporting date may not be at the commencement of a fortnightly fees period, it may be necessary to allow for parts of the first period and the last period. The industry needs to look at how this can be more automated.
- In the case of a self licensed advice business, there will be separate statements from each product provider that will need to be consolidated.
- **Capture of information on services provided.** The admin staff will need to check the client file and records on the financial planning system to identify all services that have been provided to the client over the last 12 months. It will also be necessary to check the client agreement or previous FDS to identify the services that should be provided.
- **Preparation of formal FDS (and Opt-In) letter.** Once all the necessary information has been collected the admin staff member will need to pull a letter together for the client.
- **Review and sign-off of letter and supporting material by adviser.** Once the letter has been prepared the adviser will need to review the letter and supporting material to ensure that it is accurate and complete. It is possible that the adviser may be able to identify missing products and services provided that have not been documented. It may also be necessary for the adviser to compare the FDS with what was stated in the Statement of Advice to ensure no significant differences.
- **Send letter and retain record of letter.** Once the letter has been approved, it needs to be sent out or handed to the client. There needs to be a record of how this was done and when it was done. A copy of the letter sent to the client, must be stored in a location that can be readily retrieved
- **Follow-up questions.** It is anticipated that up to 20% of clients will make contact to request additional information with respect to the FDS or Opt-In notice. This will involve additional effort by the Admin staff and/or adviser to respond. The adviser will need to sign-off on any further communication.
- **Follow-up of missing Opt-In responses.** It is difficult to predict how many clients will not respond within a reasonable timeframe. In this event, there will need to be follow-up procedures that are undertaken by the admin staff and adviser.
- **Responding to non Opt-In cases.** At this stage it is difficult to predict how many clients will choose not to Opt-In. The workload will vary depending upon the number impacted. Where a client chooses not to Opt-In or alternatively fails to respond to an Opt-In notice, the practice will need to arrange for all fees to be discontinued. In the case of failure to respond, the adviser will need to formally write to the client to advise them of the fact that the arrangement has been terminated and the steps the client will need to take if they need advice in the future.

Adviser Cost Related to Opt-In and Fee Disclosure Statements (cont).

Cost of FDS and Opt-In:

The following table shows the key assumptions and calculations that we have used.

Staff	Cost per Hour	Hours - FDS Only Year	Cost FDS Year	Hours - Opt-In and FDS Year	Cost - Opt-In and FDS Year	Yearly Average
Admin Staff	$40	1	$40	2	$80	$60
Adviser	$120	0.5	$60	0.5	$60	$60
Total		**1.5**	**$100**	**2.5**	**$140**	**$120**

Based upon these numbers, the cost per client will be $100 in the year when the FDS is required, but no Opt-In notice is required. In the year when both the FDS and the Opt-In are required, the cost will be $140. On average, this results in a cost across the two years of $120 per client per year.

For a business of 300 clients, this will work out on average at a total cost of $36,000 per year.

The costings used in these calculations reflect basic people costs and direct on-costs. They do not allow for a range of additional costs such as increased office space or the requirement for new systems. Further these costings do not include any additional costs that may be passed on by the licensee, or incurred by the product providers who pass through information on fees and commissions. If the rate of Opt-out or non response from clients is high, then the costs will increase greatly.

The complexity of complying with the FDS obligations, where the workload will be greater for adviser who use a broad range of products to suit particular client needs, may result in an unintended consequence, where these advisers will be incentivised to align themselves with particular products or product providers in order to increase efficiency. Clearly the less products that an adviser utilises the simpler the FDS process, however this may detrimentally impact upon meeting client needs.

Often an adviser will work with both members of a couple, where some products might be held separately by each individual or jointly. This will pose further complications, as the adviser will need to decide whether this represents two or three clients, and whether/how the fees for the joint product are to be divided between both members of the couple.

What Clients will lose if they Unintentionally Fail to Opt-In

The AFA is concerned that there is an incomplete understanding of the extent of potential disadvantage to clients that will flow from a case of unintentional failure to Opt-In. By this we mean cases where the client intended to continue the advice relationship, but for whatever reason failed to complete the necessary paperwork within the permitted timeframe. There has been some suggestion that the client can simply recommence an advice relationship in the event of a need arising. The AFA puts forward the view that clients do not always know when they need advice, and the timeframe under which they need to take necessary action may not allow for the creation of a new advice arrangement. The following circumstances are put forward to illustrate this point:

- For clients who hold direct shares they may receive paperwork with respect to a corporate action, such as a heavily discounted rights issue, where a failure to act will result in the loss of value.
- A change in legislative obligations that might impact upon their capacity to contribute or claim a tax deduction. As an example, people above the age of 50, who currently make concessional contributions to superannuation up to the $50,000 cap, are likely to need to change their contribution rate by 1 July 2012.
- A further example is to assess the impact of investment returns on Centrelink benefits for retired clients. This might include factors such as the timing of revenue and expenses.
- When an employee leaves their employer, their superannuation arrangement may present them with the opportunity to retain their existing insurance without the need for further underwriting, provided they take up the option within a limited timeframe.
- Where a change in the clients circumstances, may have flow on implications that might prove to be detrimental. Examples may include an increase in salary that results in superannuation contributions exceeding their cap, or failing to update insurance cover to allow for increased debt levels.
- Recognising the taxation implications that flow from significant birthdays (55, 60, 65) which might open up opportunities for strategies such as Transition to Retirement.
- Providing a reminder about eligibility for co-contribution.
- Enabling the continuation of ongoing strategies which necessitate annual actions, such as eligible spouse contributions.
- Assist a client or their relatives with submitting an insurance claim.

Analysis of Rice Warner Research – Job Losses and Increased Savings

We appreciate that there has been a lot of discussion at the PJC and in the media about job losses in the financial services industry as a result of FoFA. The research that has been quoted are two pieces by Rice Warner on behalf of the ISN. The first report from March 2010 predicted the loss of 6,800 advisers. The most recent report from January 2012 predicts a loss of 3,000 full service advisers. Either way, this legislation is going to see a reduction in the number of advisers. The issue is not whether there will be a loss of jobs, but how much.

We recognise the work that Rice Warner has done in producing these reports and the model behind them. Their model is extremely complex, and relies upon a range of assumptions. We don't intend to attack their research, but will point out that the outcome (in terms of job losses), is very dependent on some key assumptions about the percentage of the population that take up advice each year. They have assumed that the percentage of people taking full service advice will stay the same from 2012 to 2026. This is somewhat inconsistent with their assumption that the increased transparency on fees flowing from FoFA will drive more people away from full service advice towards scaled advice and in particular intra-fund advice. If for example, we reduced the 2026 assumptions on page 26 of their report, for the take up of advice by 1% or 2%, we would most likely see a much larger decrease in the number of full service advisers.

Our intent is not to criticise the Rice Warner report, but more importantly to focus on the fact that the Government should have done this research and it should have been subject to independent testing and sensitivity analysis. The AFA believes that there will be job losses and that they will be greater than 3,000 advisers. In our analysis, we have used a multiplier of five, meaning that for every adviser job that is lost, there will be a further 4 people who lose their jobs. These people are staff within an adviser's office, service providers to advisers and people in the Financial Services industry who support advisers.

There is another point that we would like to address in the Rice Warner report. It has been widely reported that their research suggests that FoFA will result in an increase in savings of $130Bn by 2026, and that this increase is due to a reduction in fees and commissions by advisers. The way this has been expressed in the covering letter by the ISN and reported in the media is fundamentally incorrect. Their research provides for a reduction in fees of $12Bn over the period; a small fraction of the $130Bn. It also allows for an increase in people taking advice and therefore having more money under advice. This is a matter of existing savings that are for the first time brought under the umbrella of advice. There is another component that provides for increased savings that flow from the receipt of advice. Those people who get advice, will invest more and contribute more into their superannuation. This is the obvious benefit that flows out of getting advice. It is incorrect to simply look at advice as something that is costly and will reduce savings. This fact stands to support the receipt of advice, not to discourage people from getting advice.

AFA Conclusion on FoFA

The AFA has assessed each of the FoFA elements based upon the following criteria:

- **Consistency.** Was the element consistent with the 2009 PJC recommendations?
- **Good Policy.** Is there a compelling reason or benefit that will be derived from the FoFA element?
- **Unintended Consequences.** What is the risk of significant unintended consequences or confusion?
- **Cost Effectiveness.** Does the compelling reason justify the additional cost (upfront and ongoing)?
- **Level Playing Field.** Does the way the element has been proposed, present issues with a level playing field in the financial services industry?

Based upon our assessment of each FoFA element utilising these criteria, our priority amendments are as follows:

- Remove Opt-In and the Fee Disclosure Statement. Neither of these two elements are consistent with the PJC recommendations, they are poor policy, with significant unintended consequences and high costs. In the context of the MySuper proposal on cross-subsidisation of intra-fund advice, they represent a level playing field issue.
- In the event that the Government completed removed Fee Disclosure Statements, the significant issues with respect to the retrospective requirements of this obligation, as proposed in Tranche 1, will be removed.
- Remove the ban on commissions for group life insurance, where advice or services are involved. This was not part of the PJC recommendations, poses an issue with inconsistency between the superannuation and ordinary life insurance environments and will have significant consequences for advisers who specialise in corporate superannuation.
- Review of the implications of the ban on volume bonuses and shelf space fees. The compelling issue to address in this area is where there is a direct impact upon the quality of the advice that flows based upon an advisers knowledge of differential remuneration outcomes. In many cases, volume bonuses will not pose this risk. Further the way the Volume based shelf space fees legislation has been designed, appears to suggest that there will be level playing field issues present.

The AFA also supports efforts to tidy up or clarify the legislation in the following areas:

- Best Interests. Greater clarity is required. The AFA supports the removal of Section 961B(2)(g) to provide for a safe harbour. Best Interests needs to be designed in a manner that will be supportive of scaled advice.
- Grandfathering. The legislation around grandfathering needs to be clear and precise with total grandfathering for all existing contractual relationships. Grandfathering should continue to apply in the context of the sale of a business or book of clients. Addressing grandfathering through the regulations is simply sub-optimal.
- ASIC Powers. Greater clarity is required with respect to the circumstances under which ASIC can and will use these powers.

The Financial Advice industry is ready for change, but in embracing change we need to ensure that it is change for a compelling reason and that it is manageable and digestible within the required timeframe. The way that the government has managed the FoFA process has opened up a significant risk of trying to do too much and having some elements of poor policy without compelling grounds that distract all the key players from what is important. If FoFA can be scaled back to what is important and compelling and tidied up, then consumers actually stand a decent chance of benefiting from this critical piece of legislative change. Thus an appropriate deferral to get everything right and to give the industry the opportunity to prepare, is not only sensible, but also good policy.

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

Richard Klipin

Chief Executive Officer
Association of Financial Advisers Ltd