21 December 2011

Mr Tim Bryant
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
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By email: corporations.joint@aph.gov.au

Dear Mr Bryant

Parliamentary Joint Committee on Corporations and Financial Services
Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

Thank you for the opportunity to make a submission to the inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. We refer to these, collectively, as the 'FOFA bills' in this submission.

The Australian Financial Markets Association (AFMA) is the leading industry association promoting efficiency, integrity and professionalism in Australia's financial markets and provides leadership in advancing the interests of all market participants. These markets are an integral feature of the economy and perform the vital function of facilitating the efficient use of capital and management of risk. Market participants perform a range of important roles within these markets, including financial intermediation and market making.

AFMA represents over 130 members, including Australian and international banks, leading brokers, securities companies, State Government treasury corporations, fund managers, traders in electricity and other specialised markets and industry service providers.

AFMA does not propose to make detailed comments about each component of the FOFA bills in this submission. AFMA has been directly engaged with Treasury and the

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Government in the development of the draft legislation through the peak consultation group, and has made detailed submissions through that process on matters of regulatory policy, as well as the drafting of the proposed legislative provisions contained in the FOFA bills.

We note that as at the time of making this submission, a number of significant matters that go to the way in which AFMA members will implement and comply with the FOFA reforms on an ongoing basis are yet to be resolved. These include the proposed grandfathering of certain existing remuneration arrangements into the new regime, and the proposed carve out for fees connected to brokerage and fees for capital raising activities, referred to by the (then) Assistant Treasurer and Minister for Financial Services and Superannuation in his media release of 29 August 2011. We understand these matters are to be dealt with by way of regulations, which have not yet been made available for public consultation. In addition, AFMA has made submissions on behalf of its members, all of which are publicly available, in relation to certain types of business activities where we believe there are good policy and regulatory grounds to exclude these activities from the FOFA reforms, and we understand that these issues are still under active consideration by Treasury and the Minister.

AFMA is of the view that it is more useful for the purposes of the Parliamentary Joint Committee on Corporations and Financial Services (the Committee) inquiry to provide comments about what we understand to have been the original policy intent of the FOFA reforms, arising out of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into Financial Products and Services in Australia Report dated November 2009 (the Ripoll Report), and whether the proposed reforms are a measured response to the recommendations of that report.

We make the following comments for the Committee's consideration.

1. AFMA supports the Government's policy objective

AFMA supports the Government's policy objective to minimise the possibility of retail clients receiving advice that is, or potentially may be, affected by conflicted remuneration structures. It is appropriate that financial advisers should place the best interests of their client ahead of their own when providing personal advice to retail clients.

To date, AFMA members and many other participants in Australian financial markets have operated on the basis that there is a common law fiduciary duty owing to their clients, which under Australian jurisprudence has been interpreted to mean acting in the best interests of the client. The Government's policy to introduce a statutory fiduciary-style duty that will require an adviser to act in the best interests of his/her client will supplement the common law and the statutory rules governing advice under the Corporations Act.

2. The scope of the reforms is wider than anticipated following the release of the Ripoll Report

The terms of reference of the Inquiry into Financial Products and Services in Australia (the PJC inquiry) related to issues associated with recent financial product and service provider collapses such as Storm Financial, Opes Prime and other similar collapses, with particular regard to the matters set out in the terms of reference[1] (which have not been repeated here).

Recommendations 1, 2 and 3 of the Ripoll Report specifically referred to financial advisers. Recommendation 4 of the Ripoll Report recommended 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.[2]

As part of its submissions to Treasury in the consultation process for the development of the reforms, AFMA said that while we appreciate there are concerns about creating and maintaining a level playing field throughout the implementation of the reforms, it is also a good policy principle that regulation should be targeted to deal with identified market failures so that it does not impose widely applied cost burdens on market participants generally where there is no identified problem, and the additional regulation would not result in any real benefit to retail investors.

Notwithstanding that the PJC inquiry related to the collapse of particular financial services licensees in particular circumstances, and the recommendations contained in the Ripoll Report were specific to particular areas, the FOFA legislative reform package has wide reaching and broad implications for the whole sector of the financial services industry that provides services and products to retail investors. This is despite the Government's acknowledgement, at the time the first tranche of the draft legislation was released, that not all participants in the sector providing services and products to retail investors who are impacted by the reforms featured in the findings of the PJC inquiry, nor have they been found to be conducting their business in a way that results in retail investors receiving advice that is conflicted by remuneration structures.

AFMA made significant efforts in the lead up to the release of the first tranche of the draft legislation to ensure that brokerage (remuneration paid to brokers for the execution of transactions in exchange traded products) and fees connected to capital raising activities, which were not the focus of the PJC inquiry or the reforms announced by the Government, would not be captured by the legislation. While AFMA very much appreciates the Minister's confirmation that brokerage and fees connected to capital raising activities will not be unduly impacted by the reforms, we feel the legislative design process should have delivered better-targeted regulation and should not have led us to a position where it required a Ministerial decision to ensure that activities which were never meant to be captured by the reforms, would in fact be expressly carved out.

[1] Parliamentary Joint Committee on Corporations and Financial Services – Inquiry into Financial Products and Services in Australia November 2009 – Terms of reference, page vii.
[2] Ibid, pages 150 and 151

We note that the Regulation Taskforce in 2006, which was asked to identify practical options to alleviate the regulatory compliance burden on business, observed that regulation that influences more activity than originally intended or warranted is a contributor to an excessive compliance burden on business. The lesson is that better regulation requires effective targeting of regulatory interventions to address only the market failure that is identified and proven.

It is generally held within industry that the FOFA reforms have gone well beyond the focus of the PJC inquiry and now capture many forms of financial services business models and remuneration structures where advice is given to a retail investor, even where there is no prospect or only a very remote prospect of a retail investor receiving conflicted advice as a result of the particular business model and/or remuneration structure. Certainly, the reforms are not limited to ceasing payments from product manufacturers to financial advisers.

This fundamental underlying principle of the reforms – to prevent a retail investor from receiving conflicted advice that is motivated by inappropriate incentives given to an adviser or financial services licensee – has been lost sight of. Appropriate incentive structures can promote productivity and innovation and are common in many industries. It should not be assumed, and it has not been empirically demonstrated as far as AFMA is aware, that all forms of incentive structures result in a negative outcome for retail investors in all cases. However, the proposed reforms have the effect of eliminating many of the existing incentive structures in financial services even if they are not problematic and have not been shown to produce adverse outcomes for retail investors.

3. A transition period is needed

AFMA members will face difficulties in implementing the FOFA reforms based on the published timetable under which the provisions become effective on 1 July 2012.

The first tranche of the draft legislation was released on 29th August 2011 with a short public consultation of 14 business days not including the day it was released. AFMA's observations, and that of its members and other sectors of the financial services industry, were that the first tranche included a number of unexpected and unanticipated provisions, which was an unfortunate outcome given the extended period of consultation and submissions that had occurred in relation to the reforms before the release of the first tranche. Ideally, there would have been no surprises for industry at that stage of the consultation process.

The second tranche of the draft legislation was released on 28th September 2011, again with a short consultation period of 14 business days not including the day it was released.

It appears that the consultation periods on both the first and second tranches of the draft legislation were driven largely by a desire to introduce the legislation into Parliament by a certain time, and as a result, there was insufficient time for all parties

affected by the proposed legislation to review the draft provisions and consider how the changes will impact them in a fulsome and holistic manner.

From the perspective of AFMA members, there are critical provisions not contained in the FOFA bills – not the least of which are grandfathering provisions and the arrangements to ensure that brokerage and fees connected to capital raising are clearly and unambiguously excluded from the application of the legislation – which need to be in place before our members can understand the whole of the effect of the FOFA reforms on their business operations and take appropriate steps to ensure they are able to comply with the legislation.

Many AFMA members operate complex, sophisticated, integrated businesses. In the absence of a complete package of reforms, including all of the legislation and all of the necessary regulations, it is very difficult for our members to understand how the reforms will affect the totality of their business, and commence to make all the changes to systems, client documentation and agreements, training and compliance programs, employment and other HR arrangements (including remuneration arrangements) that will be needed to ensure they will be FOFA compliant.

The FOFA reforms represent the most significant change to the law governing financial services since the introduction of the Financial Services Reform Act 2001. Those reforms became effective on 11th March 2002 and included a 2 year transition period, ending on 10th March 2004. AFMA is concerned that the package of FOFA reforms is not likely to be passed through Parliament until around the end of the first calendar quarter of 2012, with many obligations due to commence on 1st July 2012. This means that the financial services industry will have only slightly more than 3 months (depending on the date of passage) to comply with the new legislative requirements. However, the systems, processes and procedural changes required (and in particular, IT-related changes) to implement the reforms will be significant, comprehensive and costly for financial services providers.

It is also important to recognise that the FOFA reforms are being introduced at or around the same time as a number of other significant financial markets and financial services regulatory changes including:

- the Basel III reforms;
- G-20 reforms for financial services and markets regulation;
- financial market infrastructure reforms proposed by the Council of Financial Regulators;
- the Personal Property Securities Act;
- "Stronger superannuation" reforms;
- consumer credit reforms;
- banking competition reforms;
- insurance capital regime changes;
- tax agent services reforms;

- the US Foreign Account Tax Compliance Act (FATCA);and
- Financial Action Task Force changes to its recommendations relating to prevention of money laundering and terrorism financing which are implemented in Australia through the Anti-Money Laundering/Counter-Terrorism Financing Act 2006 and regulation by AUSTRAC.

Given the significance of the FOFA reforms and their wide ranging impact on the financial services sector, AFMA believes that a transition period of at least 12 months, and preferably 2 years, should be provided.

AFMA has raised the prospect of a transition period with Treasury and the Minister, and at the time of writing this submission, we understand it is still under consideration.

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AFMA would be pleased to discuss any aspect of this submission with the Committee.