FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

Proposed FOFA Amendments: The FACTS

PRESENTING THE FACTS ABOUT THE MYTHS DATE: 30.04.2014

This document presents some statements made about the proposed FoFA amendments by a number of different sources, and clarification of facts in relation to those statements.

FOFA ISSUE	FOFA MYTH	FOFA FACT
Opt-In	Removing the 'opt-in' requirements would take away the obligation on financial planners and advisers to contact their clients every two years and obtain express consent to renew their arrangements with their adviser or planner in relation to ongoing commissions and fees.	Opt-in only applies to new clients who sign up to an ongoing fee arrangement post-1 July 2013, which **does not include** any form of commissions because they are banned. Therefore existing clients who are paying a trailing commission to either a financial adviser or their product provider **will not** be issued with an Opt-In notice.
	Removing opt-in represents a major consumer detriment. Removing the opt-in will cost consumers a significant amount over their working life, especially in relation to superannuation.	If client inertia results in a failure to opt in, the client's investments remain in place yet the planners' ability to provide investment management services is stopped, leaving the investments unmanaged and consumers at risk.
	Without the opt-in, there is no mechanism to ensure that ongoing fees are only being charged where ongoing advice (or at least ongoing communication) is being received. The fact that clients often stay in an ongoing fee arrangement with an adviser despite having almost no engagement with the adviser is known as the 'soft lock' on financial advice. Opt-In solves the 'soft lock' for ongoing fees by forcing an opt-in decision every 2 years.	Most clients receive advice under a client service agreement, which are negotiated to meet the service needs of the client, includes and enables the client to opt out at any time. It also details the timing and circumstances of financial plan reviews, and the ongoing services to be provided (such as portfolio managements), based on the needs and desires of the client. Opt-In negates these contracts. The Opt-In renewal notice creates additional regulatory burdens on top of existing client/adviser negotiated arrangements, and provides dual regulation over professional obligations. Financial planners who are members of a professional association already embody values of client engagement as part of their value proposition as well as alignment with a code of professional practice.
	Financial planners have already prepared for Opt-In so the cost savings of abandoning it will be minimal.	Opt-In is a prospective measure and applies only to clients with ongoing fee arrangements established after 1 July 2013 (section 962D). The Opt-In laws require an Opt-In renewal notice to be provided to such clients two years after the ongoing fee arrangement was signed (section 962L). Therefore, at the earliest, financial planners will not be required to provide the first opt-in renewal notice until 1 July 2015 (assuming an ongoing fee was entered into on 1 July 2013). Hence, many planners have at this stage not prepared the systems and processes required to meet the Opt-In requirement. Focus has been on ensuring compliance with other FoFA requirements that have already commenced. Advice costs will increase, reducing the affordability for Australians to access to advice. Small businesses will be compromised, as they will be required to implement more 'red tape' adding costs and complexities to their businesses.

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Fee Disclosure Statements	Although the FoFA reforms only came into effect on 1 July 2013, advisers and planners must still report annually on their fees and commissions to their clients even though the original advice and investment happened years before. The FDS states all the fees and commissions received by the adviser or planner from the client or the client's investments within the previous 12 months.	There is a misunderstanding of the FDS requirements. Commissions are **not required** to be disclosed in a FDS The Replacement Explanatory Memorandum notes at para 1.13 that an ongoing fee paid by a third party to an AFS licensee or a representative (which would include a commission) will generally not constitute an ongoing fee for the purposes of sections 962A(1)(c) and 962A(2)(c). ASIC RG 245 on FDS states that: *We therefore consider that commissions generally do not need to be disclosed in the FDS, on the basis that they are paid under a commercial arrangement between a product issuer or platform operator and an AFS licensee or a Representative.* (RG245.38)
	Existing clients will have no consolidated communication of ongoing fees.	Financial planners are already required to clearly disclosure the fees and commissions they receive from both the client and third parties in relation to the advice in the SOA and other disclosure documents, Further, annual product fee statements provided to the client by the product provider must clearly state the commissions paid to the planner. The FDS requirements unnecessarily duplicate existing disclosures of advice fees which are included in annual statement requirements of superannuation funds and product providers.
	It is not difficult or costly to make an FDS. Notwithstanding the complaints of industry regarding the cost of compliance with this measure, the benefits to consumers far outweigh the estimated cost to industry.	The retrospective application of the FDS law creates a significant cost for industry and does not deal with the original policy intent of commissions. As the FDS was not previously required, there were no systems in place to record and collect the required data at the time the services were provided to the clients prior to the new law commencing in July 2013. Collecting such data retrospectively for the first FDS is an extremely costly exercise. Some information required by the FDS, such as advice fees, may rely on data generation from a third party, and this information sourcing process may be time consuming and prone to delay. For example, where the advice fee is related to asset pricing, data may need to be gathered from multiple third parties, with each being beyond the control of the planner and licensee.

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<table>
<tr><th>FOFA ISSUE</th><th>FOFA MYTH</th><th>FOFA FACT</th></tr>
<tr><td rowspan="2">Best Interests: ‘Catch-all’ provision</td>
<td>If the ‘catch-all’ provision is removed, planners will be able to meet the best interests duty without having to act in, or even consider, the client’s best interests.

Removing section 961E deprives a provider of advice of any guidance as to how their conduct will be judged by ASIC or the courts.</td>
<td>Section 961B(1) determines that financial advisers have to act in the best interest of their client. That particular section remains as is. Section 961B(2) provides a checklist of the steps that a financial planner has to take in order to satisfy the best-interest duty. This includes
the subject matter, giving consideration to the objectives, the financial position, the relevant circumstances of the client and asking questions to identify all of the relevant facts;
making a judgement on whether or not the planner is appropriately qualified to provide the advice given the circumstances that are in front of them and decline to provide the advice if they are not;
researching the products and providing advice in the best interest of the client.
All of these parts of the best-interest duty test remain and will require financial planners to act in the best interest of the client.</td></tr>
<tr><td>Removing section 961B(2)(g) will mean that the best interests duty will be exactly what was required before FoFA.
<u>Relevant circumstances: </u>(2)(a), (b), and (c) were covered by the old section 945A
<u>Competency:</u>(2)(d) is covered by the licensing obligations and RG 146
<u>Reasonable investigation:</u> (2)(e) and (f) were covered by the old section 945A
961B(2)(a)-(f) therefore function purely as a ‘tick-a-box’ check-list for advisers, which can be satisfied without having to provide advice that is actually in the client’s best interests. Therefore, removing the ‘catch-all’ provision represents a major consumer detriment.</td>
<td>The impact of the removal of the ‘catch all’ provisions of the best interests duty, must be considered in the context of the other provisions in the Act which are included as part of the best interests duty obligations.

The financial advice must still be:
in the client’s best interest (section 961B)
<u>appropriate</u> for the client (section 961G), and
the financial planner must <u>prioritise the client’s interests</u> (section 961J) ahead of their own.
The combination of the remaining provisions provide stronger consumer protections than the pre-FoFA provisions. Further, the amended FoFA requirements (without the ‘catch-all’ provisions) enable the workable and practical implementation of, and compliance with, the new law.

Section 961B(2)(f) requires professional judgement as one of the steps. This was not a requirement before FoFA and requires the financial planner to base all judgements they make in advising the client on the client’s relevant circumstances. This includes judgement about the scope of the advice, the inquires they make, the strategies and products they recommend.</td></tr>
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Best Interests: 'Catch-all' provision (cont'd)	Removing section 961B(2)(g) makes it easier for advisers and planners to defend a claim for negligent advice or advice that was not in the best interests of the client.	The catch-all provision of the best interests duty has created uncertainty, significant litigation risk, and an artificial approach to regulating financial advice culture in Australia. Indeed, the consumer protection offered by the catch-all is largely illusory, as it can only be realised through litigation by ASIC. It does not affect the existing legal remedies for victims of negligent advice.
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Scaled Advice	Removing the 'catch-all' provision and inserting section 961B(4A) will reduce dramatically the incentive for a planner to consider the entirety of a consumer's position when the consumer investor, in their ignorance of the market and financial matters, has expressly asked for 'limited' or scaled advice thinking it will cost them less.	Scaled advice is the decision process for deciding the subject matter of the advice that will help facilitate affordable advice to more Australians. The best interest duty safe harbour steps and the other related obligations are still required including the requirement to inquire into the clients financial situation, objectives and needs that are relevant to the client and the subject matter of the advice.
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Grandfathering	The proposed regulations will allow financial planners to retain commissions for longer, and to sell client books at a higher value based on commission payments. The proposal makes commissions taken from people's super a tradable commodity. This will cost consumers thousands of dollars.	Both sides of Government agreed that the FOFA legislation would be prospective changes and not retrospective. This is general practice in all good legislation and there are constitutional elements regarding the protection of property rights that need to be considered. Further the grandfathering arrangements are already legislated, the regulation amendments are to help clarify the conditions for which the grandfathering arrangements are available. The current grandfathering regulations impact on the fairness and equity of buying and selling of a financial planning business, and create potential restriction of trade regarding a financial planner's ability to change employers/licensees. This may force some planners to stay with a licensee.