19 January 2012

Senate Economics Committees, SG.64
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

By email: economics.sen@aph.gov.au

Dear Sir/ Madam

CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 and CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011

CPA Australia, the Institute of Chartered Accountants in Australia, and the Institute of Public Accountants (the Joint Accounting Bodies) represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies welcomes the opportunity to provide comments to the Senate Economics Legislation Committee on both the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

When implemented, the FoFA Bills will require the financial planning industry to undertake the most significant and extensive changes since the introduction of Financial Services Reform in 2001. While these reforms will be aimed at improving both the trust and confidence of the consumer in the financial planning industry and strengthening consumer protection, they will require financial planners and licensees to undertake considerable changes to their practices and systems.

Although nearly two years has passed since the FoFA reforms were first announced, the industry have largely been unable to implemented many of the proposed changes as the details of the new obligations will not be known until the legislation successfully passes through Parliament.

Further, a large proportion of the financial planning industry will also be required to make considerable changes to their systems as a result of Stronger Super reforms.

For these reforms to achieve the government's policy objectives it is vital that the implementation and transition periods are appropriately aligned to deliver the required policy outcomes for the government, industry and consumers.

Therefore while the Joint Accounting Bodies are pleased that ASIC will adopt a facilitative compliance approach for the first 12 months of the implementation of the FoFA reforms, we believe further consideration must be undertaken to ensure the proposed timetable for implementation provides an effective and practical transition period.

In this regard the Joint Accounting Bodies recommend that the current commencement date of the FoFA Bills be extended until 1 July 2013 to ensure an effective transition and minimise the cost and impact of both the

FoFA and Stronger Super reforms on licensees and product providers. However, to ensure the effective regulation of the financial services industry we support the enhancements to ASIC's licensing powers and banning powers commencing 1 July 2012 as currently scheduled.

Corporations Amendment (Future of Financial Advice) Bill 2011

Regarding the Corporations Amendment (Future of Financial Advice) Bill 2011, the Joint Accounting Bodies support the introduction of a mandatory two year opt-in process as an important pillar of the FoFA reforms.

This initiative will assist clients who are actively involved with their financial future assess whether the services they are receiving reflect value for money before they decide to renew an ongoing fee arrangement. It will also protect new clients who have become disengaged over time and clients who are not yet fully engaged in the client / financial planner relationship from paying ongoing fees where they receive little or no service.

We believe this protection mechanism should be afforded to both existing and new clients. However, the compromise of requiring the provision of an annual fee disclosure statement to all clients will assist in ensuring existing clients still have the opportunity to make an informed decision if they are receiving value for the ongoing fees they are being charged. This process will build greater trust and further develop the financial planning industry's progress towards being recognised as a profession.

Importantly, transparency and honesty are essential elements in a trusted relationship between a financial planner and a client. Implementing these mandatory ongoing disclosure requirements will ensure that these principles are upheld in all client engagements.

However, key to the success of these reforms will be that the prescribed form of these disclosure documents are clear, concise, and therefore effective. Further, an important element of this disclosure is to encourage proactive engagement by the client

While the regulations may provide the particular information that may or may not be required in the statements, care must be taken to ensure that any prescribed information is not overly prescriptive or requires unnecessary detail. Ideally, the disclosure statements should be kept to a maximum of one A4 page and simply state the main services that have or will be provided during the disclosure period. It should not be used to list every contact, call or action for the relevant period. Keeping these disclosure documents simple and straightforward will ensure they remain a useful tool for clients and not become another excessive disclosure statement that results in the client becoming disengaged with planning for their financial future.

This reform is also an opportunity for those financial advisers who do not already regularly engage with their clients and seek their ongoing consent to charge advice fees to now demonstrate the real value of their advice. If the industry can begin to effectively communicate the benefit and value of seeking financial advice, the wider community will begin to understand these benefits and this may encourage more people to actively seek advice.

In regard to the specific requirements of this Bill, the key recommendations raised in our submission are as follows:

- Further guidance should be issued to clearly state whether commissions that are still permissible, such as a commission paid by a product provider to a financial adviser for a life insurance product, would be considered to be a fee paid by the client and as such would be required to be disclosed on the respective notices
- Remove subsection (f) from section 962H Fee disclosure statements, as the information it requires to be disclosed is speculative and may potentially confuse, rather than inform the consumer
- Section 962N should be amended to state where a client fails to renew an ongoing fee arrangement, the arrangement terminates at the end of the renewal period and the only further obligation of the financial adviser to the client is to ensure any existing payment arrangements are ceased within 30 days
- If a commission is considered to be a fee paid by the client and must be disclosed on the renewal notice and annual fee disclosure notice, then section 962Q must be reviewed to ensure there are no unintended consequences where a client does not actively renew the ongoing fee arrangement, and
- ASIC issue a practice statement which sets out how they intend to use the proposed powers and in particular, how they will interpret 'believe' and 'likely to contravene'.

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

The Joint Accounting Bodies believe the best interests duty and conflicted remuneration are also key elements of the FoFA reform package and are integral to achieving the original stated objectives of improving the trust and confidence of Australian retail investors in the financial planning sector.

The complexity of the financial products, the volatility of the financial markets, the increased onus on consumers to make active financial decisions including through compulsory superannuation and the low levels of financial literacy further underpin the need to ensure the quality of financial advice provided to consumers. More and more consumers are being encouraged to be actively engaged with their finances and seek professional financial advice.

The Joint Accounting Bodies believe the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory best interests obligation will embed this motivation in the financial advice framework to ensure all financial planners make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates. We believe introducing this obligation will improve the public's trust and confidence in the advice they receive.

The removal of conflicted remuneration structures, which include commissions and volume-based payments, is also pivotal to achieving the objectives of the FoFA reforms and to ensure all advice is focused on the needs of the client. We believe this will further strengthen consumer confidence and trust in financial advice.

This reform would not only address any real conflicts that may exist, but will also importantly assist in addressing lingering negative perceptions some consumers may have of the financial planning industry. For these reasons, the Joint Accounting Bodies have long supported the removal of conflicted remuneration.

While the Joint Accounting Bodies support the government's endeavours to remove conflicts of interest, we believe that all payments deemed to be conflicted remuneration should be regulated consistently. We are concerned that the proposed carve-outs may in fact weaken the effectiveness of the overall reforms and add a further level of administrative and compliance complexity.

In regard to the specific requirements of this Bill, the key recommendations raised in our submission are as follows:

- The best interests obligation should be extended to include advice provided to wholesale clients
- All commissions on life risk insurance products, including those sold within or outside of superannuation, should be consistently regulated. Given their potential to cause real or perceived conflicts of interest, commissions should not be carved-out under section 963B
- Execution-only sales should not be carved-out under section 963B, as this exclusion may lead to an inherent conflict between remuneration models where advice is and is not provided. Further, it may also encourage licensees (and financial planers) to move away from providing financial advice
- A platform operator should only be allowed to receive an asset management fee discount in the form of a rebate on the basis that it represents reasonable scale of efficiencies and if the value of this rebate is passed on to the clients invested in the respective fund, and
- Asset based fees should be banned where there is any leverage involved in the retail client's investment portfolio to ensure the reform achieves the correct policy outcomes.

If you have any questions regarding this submission, please do not hesitate to contact Keddie Waller (CPA Australia) at keddie.waller@cpaaustralia.com.au, Hugh Elvy (the Institute) at hugh.elvy@charteredaccountants.com.au or Reece Agland (IPA) at reece.agland@publicaccountants.org.au.

Yours sincerely

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Corporations Amendment (Future of Financial Advice) Bill 2011

1. Charging ongoing fees to clients

Section 962A Ongoing fee arrangement

As stated in the Explanatory Memorandum to the FoFA Bill, the ongoing fee arrangement will apply to financial advisers in situations where they provide personal advice to a retail client, and the client pays a fee which does not relate to advice that has already been given at the time of the arrangement is entered into. The obligation to provide the compulsory disclosure and renewal notice will only apply where the ongoing fee will be charged for a period of 12 months of more.

However, clarity is required as to whether commissions that are still permissible, such as a commission paid by a product provider to a financial adviser for a life insurance product, would be considered to be a fee paid by the client and as such would be required to be disclosed on the respective notices.

Recommendation:

- **Further guidance should be issued to clearly state whether commissions that are still permissible, such as a commission paid by a product provider to a financial adviser for a life insurance product, would be considered to be a fee paid by the client and as such would be required to be disclosed on the respective notices.**

Section 962H Fee disclosure statements

The Joint Accounting Bodies support a mandatory fee disclosure statement which clearly states the fees paid by the client in the previous 12 months, the services the client was entitled to and the services the client actually received.

We also support the inclusion of the anticipated fee for the following year as well as the details of the services the client is entitled to receive during this period. By including this level of detail it will assist the client to understand the fees and services they have received and make an informed decision if they wish to continue with these services for the following 12 months.

However, we do not support the requirement to include the details of the services the financial adviser anticipates the client will receive during the following 12 months. As well as being speculative, requiring the inclusion of this information will not assist the client in making an informed decision. Rather, it will potentially lead to confusion and excessive information being included in the fee disclosure statement.

The inclusion of the services the client was entitled to in the previous 12 months as well as the services the client actually received during this period, provides sufficient information to assist the client make a well informed decision if they wish to continue their ongoing fee arrangement with their financial adviser.

Recommendation:

- **Remove subsection (f) from section 962H Fee disclosure statements, as the information it requires to be disclosed is speculative and may potentially confuse, rather than inform the consumer.**

Section 962N If client does not notify fee recipient that client wishes to review.

Currently this section states that where a client does not renew the ongoing fee arrangement, the arrangement terminates at the end of a further period of 30 days after the end of the renewal period for the arrangement.

We recommend that this section is redrafted to reflect the arrangement terminates at the end of the renewal period and further 30 days is only provided to ensure the financial adviser has appropriate time to cease any existing payment arrangements.

Further, as reflected in section 962Q, during this additional period the financial adviser should have no further obligations or duty to provide ongoing advice or services to the client with the exception of ensuring that any ongoing fee arrangements are ceased from a administrative perspective.

Recommendation:

- **Section 962N should be amended to state where a client fails to renew an ongoing fee arrangement, the arrangement terminates at the end of the renewal period and the only further obligation of the financial adviser to the client is to ensure any existing payment arrangements are ceased within 30 days.**

Section 962Q Effect of termination

The Joint Accounting Bodies support the specific inclusion of this section.

It provides certainty that where the ongoing provision of a service under an ongoing fee arrangement is dependent on the continued payment of an ongoing fee, that upon termination of the arrangement, the obligation to continue to provide the service also terminates.

However, following our earlier comments clarity is required to confirm if a commission paid by a product provider, for example in respect of life insurance, to a financial adviser would be considered a fee paid by the client. If a commission is considered to be a fee paid by the client, this effectively implies the financial adviser is obliged to continue to provide the ongoing advice and services for as long as the client retains the product despite the fact that the client may not actively renew the ongoing fee arrangement.

We do not believe that this is the intention of this section and recommend further consideration is given to ensuring a practical outcome.

Recommendation:

- **If a commission is considered to be a fee paid by the client and must be disclosed on the renewal notice and annual fee disclosure notice, then section 962Q must be reviewed to ensure there are no unintended consequences where a client does not actively renew the ongoing fee arrangement.**

2. Enhancements to ASIC's licensing and banning powers

The Joint Accounting Bodies believe that if ASIC is to be provided additional powers as set out in the draft legislation, that serious consideration be given to ensure that there are rigorous rules around ASIC's use of such powers. While we appreciate the difficulty that ASIC has where it believes a person may breach their requirements and limitations of the current law, it is also important that procedural fairness is protected.

Therefore, we are of the opinion that ASIC be required to set out in a practice statement how it intends to use the new powers. In particular, how ASIC will interpret 'believe' and 'likely to contravene'. These are broad terms and therefore have the capacity for misuse. While we believe that ASIC has no intention to misuse such powers, in order to generate confidence in the new system ASIC must set out how it will interpret the law and how it will implement them.

Recommendation:

- **ASIC issue a practice statement which sets out how they intend to use the proposed powers and in particular, how they will interpret 'believe' and 'likely to contravene'.**

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

1. Best interests obligations

The Joint Accounting Bodies believe that the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory 'best interests' obligation will embed this obligation in the financial advice framework. This will ensure providers of financial advice make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates.

The proposed obligation achieves an appropriate balance of maintaining the principal of the obligation while providing appropriate guidance as to what is required to satisfy the duty. This balance should positively encourage behavioural changes that will be in the public interest.

The best interests obligation is intended to only apply to personal advice provided to a retail client. However, the Joint Accounting Bodies believe this obligation should be extended to include financial advice provided to wholesale clients. While we understand the Government is yet to announce their view on the appropriateness of the current distinction between wholesale and retail clients, the fact of the matter is that advice provided to wholesale clients should still be in the best interests of the client. Further, the provider of the advice should be required to give priority to the interests of the client over their own interests, or the interests of their licensee or any associate of the licensee.

All financial planning advice must be in the client's best interests, irrespective of whether the client is classed as a retail or a wholesale investor. Choosing to exclude advice provided to wholesale clients from the best interests obligation could be perceived as recognition that this advice may in fact not always be in the best interests of the wholesale client. We do not believe this is in keeping with intention of the FoFA reforms.

Recommendation:

- **The best interests obligation should be extended to include advice provided to wholesale clients.**

2. Conflicted remuneration and other banned remuneration

While the Joint Accounting Bodies support the legislation's endeavours to remove conflicts of interest, we believe that all payments deemed to be conflicted remuneration should be regulated consistently.

We are concerned that the proposed carve-outs may in fact weaken the effectiveness of the reforms and potentially add further complexity for advice providers and consumers.

Section 963B Monetary benefit given in certain circumstances not conflicted remuneration

Life insurance products outside superannuation and within non-default superannuation funds

The Joint Accounting Bodies are of the view that all commissions have the potential for real and perceived conflicts of interest and should therefore be banned. Remuneration models based on a commission structure do not align with the services generally provided by a professional. However, we recognise the practical implications this entails and any change requires an appropriate and practical transition period.

We believe the inconsistency in how commissions on insurance for life risk products sold outside of superannuation and individual life risk policies within superannuation for non-default funds adds unnecessary complexity. Further, it encourages the retention of conflicted remuneration models.

All payments deemed to be conflicted remuneration should be regulated consistently.

Choosing to not ban conflicted remuneration on life risk insurance products in these specific circumstances, irrespective of the best interests obligation, risks the continued provision, perceived or real, of inappropriate advice to consumers who seek advice on these products.

The Joint Accounting Bodies do not believe there are sufficient grounds to warrant these products being excluded from the regulation proposed to apply to other like products. Such 'carve-outs' add complexity and cost to the provision and administration of advice, which will ultimately be passed on to the consumer.

On 28 April 2011 the Government stated that banning all forms of commissions within superannuation is in the best interests of consumers[1].

This position is consistent with the recommendation 5.12 of the *Cooper Review:*

Upfront and trailing commissions and similar payments should be prohibited in respect of any insurance offered to any superannuation entity, including to SMSFs, regardless of rules on commissions that might apply outside superannuation.

It is also consistent with the findings of ASIC, where in *Report 69 Shadow Shopping survey on superannuation advice* they found that unreasonable advice was three – six times more common where the adviser had an actual conflict of interest over remuneration (e.g. commissions) or recommending associated products[2].

For this reason the Joint Accounting Bodies recommend that commissions on all life risk insurance products are consistently regulated, including those within and outside of superannuation. Further, given their potential to cause real or perceived conflicts of interest, they should not be carved-out under section 963B.

Recommendation:

- **All commissions on life risk insurance products, including those sold within or outside of superannuation, should be consistently regulated. Given their potential to cause real or perceived conflicts of interest, commissions should not be carved-out under section 963B.**

Execution-only sales

While we understand the objective of the draft legislation is to ban the receipt of certain remuneration by licensees which may have the potential to influence advice, we recommend the ban should be extended to include execution-only sales.

The proposed carve-out may motivate behaviour which encourages execution-only sales and lead to an inherent conflict between different remuneration models where advice is and is not provided. It may further encourage licensees to provide execution-only sales rather than provide advice.

Non-advice or execution-only services is in simple terms an administration service and as a result a remuneration model should align with the actual service being provided (e.g. fixed fee / flat dollar) as opposed to a remuneration structure based on sales.

Given the potential conflicts between different remuneration models and that this exclusion may encourage licensees to (intentionally or unintentionally) move away from providing financial advice, the Joint Accounting Bodies recommend that execution-only sales are not carved out under section 963B.

Recommendation:

- **Execution-only sales should not be carved-out under section 963B, as this exclusion may lead to an inherent conflict between remuneration models where advice is and is not provided. Further, it may also encourage licensees (and financial planers) to move away from providing financial advice.**

1 Future of Financial Advice 2001 Information pack, 28 April 2011 p.7

2 ASIC Report 69 – Shadow shopping survey on superannuation advice p.2

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

The Joint Accounting Bodies believe that a platform operator should only be able to receive an asset-management fee discount in the form of a rebate, where it represents a reasonable value of scale efficiencies, if the value of this rebate is passed on to clients invested in the respective fund manager.

We believe there is a risk in allowing the industry to maintain forms of conflicted remuneration if the licensee can continue to receive this rebate, where the discount should rightfully be received by the client.

Recommendation:

- **A platform operator should only be allowed to receive an asset management fee discount in the form of a rebate on the basis that it represents reasonable scale of efficiencies and if the value of this rebate is passed on to the clients invested in the respective fund.**

Subdivision B Asset-based fees on borrowed amounts

As drafted, a licensee will be permitted to charge an asset-based fee on the ungeared component of a retail client's funds but not the geared component. However, previous stakeholder consultation had indicated that for this reform to have appropriate effect the ban should apply where there is any leveraged component involved in a retail client's investment strategy.

We believe permitting an asset based fee to be charged on the 'ungeared' component of a retail client's funds will create confusion for the consumer, who may as a result of this policy decision be charged via multiple remuneration models. Further, it risks licensees and their representatives adjusting pricing structures so a nil fee or a very low fixed / flat fee may be payable on the geared component of the investment fund and a higher asset-based fee is charged on the ungeared component of the investment fund. The end result is that the payment is the same dollar value as would have previously been the case where an asset based fee is paid over the entire investment amount.

Complex remuneration models may also lead to increased administration and compliance costs, which will inevitably result in the consumer having to pay a higher fee to access advice.

Further, it may result in even more confusing and complex disclosure statements being provided to consumers should the annual disclosure statement and opt-in requirements be implemented.

The Joint Accounting Bodies do not believe such outcomes would be in the public interest, nor would they remove complexity from the advice charging process. For this reason we recommend that asset based fees be banned where any component of the overall advice involves gearing.

Recommendation:

- **Asset based fees should be banned where there is any leverage involved in the retail client's investment portfolio to ensure the reform achieves the correct policy outcomes.**