ISN SUBMISSION

ISN SUBMISSION ON FOFA TRANCHE 2

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Industry Super Network

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of five million industry super members. Please direct questions and comments to:

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SUMMARY

ISN welcomes the opportunity to make a further submission to this Committee on the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* which includes the best interests duty and the bans on conflicted remuneration. This submission supplements the submission we made on the first tranche of the FOFA Reforms.

1. Best Interests Obligation

1.1 The Best Interests Obligation

The best interests obligation is the cornerstone of this reform process, and follows the recommendation made by this Committee in its inquiry into the collapse of Storm Financial, as follows:

> "The committee supports the proposal for the introduction of an explicit legislative fiduciary duty on financial advisers requiring them to place their clients' interests ahead of their own. There is no reason why advisers should not be required to meet this professional standard, nor is there any justification for the current arrangement whereby advisers can provide advice not in their clients' best interests, yet comply with section 945A of the Corporations Act. A legislative fiduciary duty would address this deficiency."

The primary policy objective to be achieved by increasing the minimum legislative obligation for financial advisers is to increase the professionalism of advice and thus consumer confidence in financial advisers. A best interests obligation is intended to ensure that personal financial advice is impartial

The legislative construction of the best interests duty includes principles based obligation in s961B(1), which is qualified by s961B(2) which sets out a number of steps which an adviser can follow to prove compliance with the duty. These process steps are atypical in a fiduciary-type duty – traditional legal thinking would usually place these types of steps into a duty of care.

ISN strongly advocated to draft the best interests duty for financial advice along more traditional lines, which would have left it as the principles-based duty contained in s961B(1). There is a significant risk that defining a professional duty through process will result in a "tick-a-box" mentality rather than shifting financial planning to a more professional culture. However, the hybrid duty put forward by the Government in s961B(1 & (2) delivers on the Government's stated objective of building 'reasonable steps' qualification into the duty, and to so appeases industry concerns about the duty being unworkable. There lingers from larger institutional stakeholders some opposition to s961B(2)(g). ISN views this step as essential to ensure that the best interests duty is not reduced to a checklist which does not move us much beyond the existing regulatory setting. The final step in s961B(2)(g) is critical to ensure that the duty retains an overriding concern for the client's interests – without this final step the obligation in s961B(2) would be insufficient in terms of the policy objectives.

There is nothing in the best interests duty as drafted within s961B which is inconsistent with the delivery of scaled or limited scope financial advice. Industry super funds, who have been market leaders in terms of rolling out limited scope financial advice services to members on their superannuation, are supportive of this duty.

However, it seems that some of the industry reaction to the steps in s961B(2) suggests that a full fact find will be necessitated, even when scalable advice is sought or provided, or that the steps otherwise obstruct the provision of limited scope advice. ISN is aware that some stakeholders have even advocated that an adviser should be able to "agree" on scope with a client in order to facilitate scaled advice. Given that the typical Australian is vastly less knowledgeable and experienced in financial matters, it is unlikely that they would understand the implications of an 'agreed' scope. While contracting out through agreement between the parties might work in a situation where two equally matched commercial parties are agreeing on terms of engagement, it is inappropriate in a consumer-professional relationship.

Properly identifying the scope of advice in the client's interests is fundamental to any professional obligation – for instance, a doctor does not always just look at the immediate symptoms of which a patient complains. The doctor may or may not question a patient to consider whether further investigation/tests are warranted. However, a doctor would not contemplate getting a patient to 'agree' to the scope of the diagnosis or treatment. In any normal professional engagement, it is incumbent on the professional to direct or advise their client, not the other way around.

However, this does not mean that the adviser need exhaust every possible contingency. The language used in the legislation couches all procedural steps in language which ensures that all that is required is what is 'reasonable'. Once a client identifies their advice need or objective, it is incumbent on the adviser to determine what issues or factors are critical to providing advice (the "need to know" issues). There may be other related issues or factors which the adviser can suggest or inquire about, but which are not critical to ensuring the client's interests are serviced by the advice. These are the client circumstances or advice issues which can be scoped out or the client warned about.

The Bill and the Explanatory Memorandum make very clear that a planner can scope advice to a single subject matter, provided this is done in the client's interests. However, as with the concerns regarding regulatory risk that once existed in relation to the FSR provisions, proposed ASIC guidance will provide concrete demonstration on delivering scaled advice which is compliant with the best interests obligation.

There are some aspects of the best interests obligation which ISN is dissatisfied with – we strongly oppose the carve outs provided in relation to general insurance products and basic banking products. Advice on these products is typically provided via general advice and so there is no justification for providing this exemption.

1.2 Requirement for advice to be appropriate

The Bill creates a new obligation for financial advice to be appropriate to the client in s961G. Where an adviser has satisfied the best interests obligation, it is likely that the advice would also be appropriate. However, this obligation is still important where the adviser has failed to comply with the best interests duty or for advice on general insurance or basic banking products which are exempted from the key aspects of the best interests obligation.

1.3 Obligation to give priority to the client's interests

Section 961J creates an obligation for a provider of personal advice to ensure that the client's obligations are prioritised ahead of any interests of the adviser, licensee, authorised representative or an associate of any of these parties. This measure originated to clarify that an adviser was not precluded from advising because of the existence of a conflict of interest. While this reform process will make some significant steps forward in terms of addressing some of the worst conflicts particularly around remuneration, there will remain some significant conflicts for large sectors of the financial advice industry including;

- Related party conflict- where the adviser is employed by a product provider or an associate of the product provider and will be influenced to recommend the related party product;
- Conflicts related to conflicted remuneration which is exempted – for instance, commissions payable on risk insurance outside MySuper and group risk insurance or volume rebates paid to a related party platform provider;
- Conflicts relating to conflicted remuneration which have been grandfathered – such as existing trail commissions or volume rebates; or
- Receipt of ongoing asset based fees from a current or new client.

ISN supports this important measure given the very significant conflicts which will continue to impact on the financial advice industry post FOFA.

2. Bans on Conflicted and Other Remuneration

ISN has long advocated for the prohibition on all conflicted forms of remuneration for financial advice. Ideally, to create a truly professional culture, advisers should only receive a time based payment directly from their client (or authorised as a one off deduction from the client's investment).

The refinement of the Government's policy position on conflicted remuneration was subject to very extensive consultation. There was obviously quite a divergence of view from industry – while most stakeholders provide at least rhetorical support for a ban on commissions, there is a lot less consensus around the less visible forms of conflicted remuneration, including the treatment of volume rebates.

ISN supports the measures dealing with regulating conflicted remuneration in the Bill, which will reduce the extent to which financial advisers will be given a financial incentive in order to recommend particular financial products. In order to achieve the public policy goals set for this reform process, that is, increasing the quality and professionalism of financial advice and thus increasing consumer confidence in planners, it is critical that these prohibitions are broad and effective.

However, there are a few aspects of the conflicted remuneration provisions in which we are disappointed:

- We strongly disagree with the concessions provided in relation to basic banking products, general insurance products and risk insurance products (other than risk products offered through default super funds or group risk products offered by super fund).
- We also strongly disagree with the permissive treatment of volume rebates, which are in effect a wholesale commission paid to incentivise product recommendations. While notionally justified on the basis that they enable a platform to realise scale benefits, the proposed regulatory setting does not ensure that the end consumer benefits from the payment of a rebate. ISN submits that volume rebates should have either been completely banned, or that they should have been permitted only if required to be passed through to the end consumer. As predicted, there will be a number of dealer groups which develop creative structures to become de facto platform or product providers to retain volume based payments.

3. Commencement Date and Grandfathering

The legislation provides extraordinarily generous transitional arrangements for the industry, which allows all conflicted remuneration arrangements put in place prior to 1 July 2012 to be retained. Such generous

grandfathering was supported on the basis that the reform package contained comprehensive measures that would better protect consumers in the future and would transform financial planners from sales agents to professional advisers.

While ISN supports the Government's intention to allow the industry a smooth transition, we nonetheless find it unacceptable that around 60% of financial planners' clients who pay commissions or ongoing advice fees receive absolutely no ongoing advice or service.

In addition to the transition arrangements in place for the renewal requirement, we would propose that these obligations should be triggered when a client is transferred to a new adviser, or where requested by a client.

Commencement date of reforms

There have recently been a number of calls for the commencement date of the reforms to be delayed.

ISN is strongly of the view that no delay is required in the commencement of the FOFA reforms. The calls for delay are yet another attempt by some in the industry who put their commercial interests ahead of the interests of consumers to obstruct the reforms.

The arguments put forward to support a delay lack merit. The reform package involves such extensive grandfathering that only new conflicted remuneration arrangements will be impacted. The ban on commissions has been well known for nearly 2 years with most large providers advertising their FOFA readiness and their pre-emptive move away from trail commissions. Members of both the FPA and FSC are subject to Codes which prohibit commissions on many new products – and must be complied with by 1 July 2012 (earlier for FPA members). If a product provider has failed to plan for the ban on commissions by 1 July 2012, then this is no reason to delay and planners should avoid recommending their products until such time as they comply and create commission free offerings.

While the disclosure and renewal requirements will commence on 1 July 2012, the first action required of a planner are not until 1 July 2013 and 1 July 2014 (respectively), so these measures already incorporate adequate time for transition.

The only other key measure is the best interests obligation. Again, the policy intention has been well telegraphed and generally supported by industry. In addition, ASIC has signalled a facilitative approach to enforcement in the first year of the reforms. Furthermore, while the best interests duty will require a review of risk management procedures, it does not require wholesale systems changes.

Layered on top of all of this is that the reforms have come through a long and extensive consultation process. And there is no question that efforts to delay are joined hand-in-hand with efforts to undermine the reforms. There is no justification for any further delay.

ISN also strongly disagrees that there is a need to align FOFA and MySuper commencement dates – in our view it is preferable for the timing to remain staggered so that the FOFA reforms precede the implementation of MySuper. It is desirable for the planning industry to have done most of their transition away from conflicted payments etc before MySuper commences.