PROFESSIONAL INVESTMENT SERVICES

Parliamentary Joint Committee on Corporations and Financial Services

Corporations Amendment (Future of Financial Advice) Bill 2011.

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1. Executive Summary

As an organisation and member of the financial advice industry, we support the key principles of the Future of Financial Advice reforms, such as the statutory best interest duty and ban on commissions on investment products, designed to improve both the quality and integrity of the financial advice industry.

We believe that the reforms, if delivered in a sensible and feasible way, will enhance consumer confidence, create greater quality of advice and strengthen the industry to allow greater availability of advice. Critical to achieving this is ensuring that the reforms provide adequate time for implementation, with prospective application, and promote further competition rather than decreasing competition in an environment which is already seeing considerable rationalisation and consolidation.

Professional Investment Services (PIS) is Australia's leading independently owned network of financial advisers and accountants and is also one of the only remaining large independently owned financial advice businesses in Australia as the other major non-institutional business Count Financial will, subject to court approval, be acquired by Commonwealth Bank as a result of the proposed FoFA reforms[1]. The significance of this should not be missed in relation to the unintended consequences of the reduction in competition from organisations outside the four pillars and AMP.

1.1 Specific measures.

We are concerned that a number of the key measures within the proposed regulation will not achieve the objectives stated above because of the following key issues:

- insufficient time is being provided for implementation (1 July 2012)
- we are imposing new contractual obligations between an adviser and client where existing contractual arrangements are already in place (requiring annual fee disclosure statement for existing clients)
- the government is proposing to take the unusual step of regulating the financial relationships between private contracting parties such as the client and adviser. We are not aware of any other industry or profession where the government mandates that clients opt-in to the ongoing service delivery provided by an adviser or other service provider (whether that be with lawyers, accountants, phone providers, health insurance providers or any ongoing subscription providers).the measures will adversely impact consumers and the 'red tape that has prevented low-cost, good quality advice being delivered to millions of Australians'[2] will in fact be increased rather than be removed.

[1] http://www.smh.com.au/business/tears-didnt-blind-boss-to-good-deal-20110830-1jk41.html
[2] http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/127.htm&pageID=003&min=brs&Year=&DocType=0

We welcome the Parliamentary Joint Commissions' review of the Corporations Amendment (Future of Financial Advice) Bill 2011 and the opportunity to provide feedback on the Bill.

When considering the issues within the Bill, we urge the Parliamentary Joint Committee (PJC) to consider the issues within the context of the complete FoFA package and the existing financial services framework. We find it extraordinary that the FoFA package has been delivered in separate tranches when a number of the key issues are fundamentally interrelated. This is extremely dangerous considering that the package of reforms is collectively designed to deal with conflicted remuneration, quality of advice and foster greater access to financial advice.[3]

In our submission we have addressed our key areas of concern with the reforms proposed in the Bill on an exceptions basis which have been outlined further below. Our position with respect to the key issues are summarised as follows:

- **Opt-In: No support.** A number of key regulatory changes to be introduced such as the best interest duty, removal of conflicted remuneration and other benefits which together with enhanced ASIC powers will significantly enhance consumer protection. Clients already have the capacity to opt-out and we do not believe that Opt-In benefits the consumer or is necessary but just adds another layer of bureaucracy to the process and unacceptable level of risk to consumers through loss of advice.

- **Fee Disclosure Requirement:** Somewhat support. The best interests duty, removal of conflicted remuneration together with the existing comprehensive disclosure framework already in place sufficiently protects consumers and discloses to clients what fees are charged. A further Fee Disclosure imposition is merely administrative replication with increasing compliance burden, driving up the cost of advice unnecessarily and without tangible benefit to the client. This is in opposition to FoFA's objectives of removing red-tape and making financial advice more affordable.

- **Retrospective legislation: No support.** We do not support fee disclosure requirement or the anti-avoidance provision from applying on a retrospective basis. Retrospective legislation should only be used in exceptional circumstances and if applied would impinge on existing rights and obligations as well as jeopardizing legitimate existing arrangements.

- **Commencement Date: Support** We support a postponement of the commencement date to no less than 12 months after the legislation receives royal assent to ensure that the industry has sufficient time to make the necessary changes and meet its legal and regulatory obligations.

[3] http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/064.htm&pageID=003&min=brs&Year=&DocType=0

These issues are discussed in further detail below. If you would like to discuss our submission or have any questions we welcome the opportunity to provide further feedback.

2. Opt-In, Renewal Notices and Fee Disclosure Statements

2.1 Opt-In – Renewal Notice Obligations

The 'opt-in' proposal requires financial advisers to provide new clients with a renewal notice every two years. The government has stated that the opt-in measure will not 'create a significant impost' on advisers who maintain regular contact with their clients and have referenced Rice Warner's estimate that the cost of opt-in will only be around $11 per client.[4]

We are seriously concerned that the cost of opt-in and the renewal notice has been grossly underestimated failing to take into account the full administrative and compliance costs involved in not only the delivery of opt-in (both from a front office and back office support perspective, requiring the introduction of new systems, policies, processes and amendments to software) but also the reinstatement process where clients fail to opt-in within the required timeframe but wish to continue receiving advice. The additional cost imposition of opt-in will increase the cost of advice which will ultimately be borne by the client. This is contrary to government's FoFA objectives of decreasing red tape and making advice more affordable.

In considering the impact of Opt-it has the government fully considered the risks to clients and the adverse implications for failing to opt-in? Where a client fails to opt-in within the required time frame not only the ongoing fee arrangement terminates but also the ongoing advice. The adviser will no longer be responsible or liable for any client loss as a result of failure to provide advice to a client after termination.[5] Whilst this may seem sensible, as it is not commercially reasonable to expect to receive ongoing services free of charge, the practical reality of this may have dire consequences for clients.

For example:

Consider the situation of Tom who has a margin loan. Tom received his opt-in notice while overseas on holiday and failed to return it within the renewal period. As Tom has been on a 6 week holiday and his renewal notice was due over 30 days ago, under the proposed legislation, he is now considered to have opted out of the ongoing fee arrangement as well as ongoing advice.

This has happened unbeknown to Tom, who is unaware that he has 'opted out' of the ongoing arrangement.

Unfortunately for Tom, there have been considerable movements in the share market and Tom has now had a margin call. As Tom is considered to have opted out of the arrangement he no longer receives advice. He is made aware of the margin call by the product provider but continuing to enjoy his holiday, he does nothing. As a consequence of not acting on the margin call, Tom's portfolio is sold and he loses his investment at the bottom of the market.

[4] See Minister Shorten's Media Release No.127 http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/127.htm&pageID=003&min=brs&Year=&DocType=0

[5] Page 15, Corporations Amendment (Future of Financial Advice) Bill 2011 Explanatory Memorandum

Unfortunately Tom is now out of pocket and he has no recourse for losses sustained from the margin call.

Had Tom been receiving ongoing advice, he would have received advice explaining the benefits and risks of topping up or selling Tom's investment. However as the relationship terminated, there was no one to provide advice when Tom needed it most. Tom's loss will not be covered by Professional Indemnity insurance as the responsibility for ongoing advice ceased when Tom did not opt-in.

Situations such as these may become increasingly common once Opt-In takes effect, even in spite of the potential risks and the severity of the consequences. Human behaviour unfortunately is not rational (see Dan Ariely, The Upside of Irrationality). Clients are notoriously bad at returning forms and whilst we hope that this will be the exception for those who want to continue to receive advice, we are concerned that this won't be., When the Committee members reflect on their own personal situation, we are sure they, themselves, have never been guilty of not returning forms or important documents within the required time frame. The significant difference between the renewal notice and other forms of general correspondence is that you are not putting yourself at significant risk.

Hopefully failure to opt-in for those who have no intention of opting out, will be the exception and not the norm, or else a great proportion of clients may suffer adverse consequences or risk increasing costs of advice. Opt-in carries inherent risks and increases costs through renewal notice obligations and follow up requirement. The cost imposition is further exacerbated by the additional cost imposition arising from the new compulsory disclosure obligation with respect to fee disclosure statements.

We believe these risks and costs far outweigh the benefits.

Recommendation: remove Opt-In on the basis that it will increase the cost of advice and poses considerable risk to the consumer through potential loss of advice.

2.2 Fee Disclosure Statements

In addition to providing new clients with a renewal notice every two years, fee disclosure statements must also be provided every 12 months in order to charge ongoing advice fees to retail clients. The fee disclosure requirements are excessively onerous in light of existing disclosure requirements already in place, as discussed further below, and require advice fee and service information for both the previous and forthcoming 12 months to be provided.

Unlike the Renewal Notice requirement however it is proposed that the fee disclosure statements must be provided **to all clients** that **currently** have ongoing fee arrangements in place and not only those who's arrangements **began after the commencement** of the legislation.

Given the detailed requirements of the fee disclosure statements, a great deal of time will be spent on preparing these for each client where an ongoing fee arrangement is in place. This has not been factored into the existing adviser and client relationship/agreement and given that it imposes new

regulatory obligations and liabilities on existing contractual relationships it amounts to retrospective legislation. Retrospective legislation should only be applied in exceptional circumstances[6] and has been utilised for significant **criminal activities** such as tax avoidance and war crimes.

We do not consider that the current proposal, introducing onerous fee disclosure statements on existing contractual relationships is of comparable significance to warrant retrospective application. Furthermore, we do not support the introduction of the fee disclosure statement on existing clients.

Should the fee disclosure statement be deemed necessary then we would support the application only to new clients and arrangements entered into after the commencement of the legislation. Grandfathering of existing clients will ensure that existing obligations and rights are not adversely affected.

The fee disclosure and renewal notice obligation are designed to ensure that clients are aware of the ongoing advice fees that are being charged and that the client actively opts-into the advice process by accepting the renewal notice. When considering the benefits and relevance of the disclosure and renewal obligation it is important to fully understand the existing fee disclosure mechanisms already in place.

2.3 Existing Fee Disclosure Requirements

Full fee disclosure is already in place in various stages of the advice process including the Financial Services Guide (FSG), the Statement of Advice (SoA), the Product Disclosure Statement and annual investment statements.[7]

The Financial Services Guide (FSG) provides remuneration disclosure that an adviser may receive which could include upfront, ongoing and any soft dollar benefits. This is provided at the beginning of the advice process, when a financial service will or is likely to be provided to a client.[8]

Clients also receive fee disclosure in the Statement of Advice (SoA) when they receive financial advice. The fee disclosure in an SoA includes remuneration, on an upfront and ongoing basis, and other benefits the adviser will receive. The remuneration is disclosed in dollar amounts. The advice and fee arrangement is agreed to with the client and the client consents by signing the SoA.

Product Disclosure Statements set out the fees and charges that a client will incur with an investment product.

Furthermore, clients also receive annual statements from the investment product providers which provides annual fee disclosure of management costs, performance fees and importantly the **adviser service fee** which is payable in association with that investment. This enables the client to clearly see the fees payable to the adviser.

[6] http://www.dpmc.gov.au/guidelines/docs/legislation_handbook.pdf
[7] http://www.financialplanningmagazine.com.au/article/Good-fee-disclosure/478441.aspx
[88] http://www.financialplanningmagazine.com.au/article/Good-fee-disclosure/478441.aspx

The existing disclosure regime provides comprehensive and transparent client disclosure of upfront and ongoing fees that are payable in relation to advice and a client's investments. Any requirement to provide further annual fee disclosure effectively amounts to increased red tape, extra administrative burden and compliance obligations (thereby increasing the cost of advice) without any additional tangible benefit to the client.

Should the client be dissatisfied with the advice or services received termination is always an option.

Recommendation: remove Fee-Disclosure requirements on the basis that it unnecessarily replicates existing disclosure requirements and will increase the cost of advice.

2.4 Client May Terminate the Arrangement at Any Time

Clients already have the opportunity to opt-out of advice at any given point in time by terminating the relationship or service with the adviser and notifying any relevant investment product providers to remove the association with the adviser.

The Opt-In renewal process is another mechanism for termination which requires clients to opt-in and renew the arrangement. Failure by the client to renew will mean the advice and the ongoing fee arrangement terminates. This is another measure which will terminate the ongoing fee and advice arrangement should the client choose not to renew the arrangement.

The Bill also addresses a client's right to termination in s962E, providing that a client may terminate the ongoing fee arrangements at any time. We have no objection to the inclusion of a termination provision, which merely reflects the rights that already exist.

2.5 Our Recommendation

In light of the full fee disclosure mechanisms already in place, new mechanisms for removal of conflicted remuneration, legislated best interest duty and a client's right to terminate the arrangement at any time, we can see no rationale for introducing the opt-in renewal notification and fee disclosure requirements.

Instead of the Opt-In renewal and ongoing fee disclosure requirement, we recommend the introduction of '**Opt-Out'** disclosure within the existing advice framework, providing disclosure to clients in the FSG and SoA that they can opt-out of the ongoing advice process and payment of ongoing fees and terminate the relationship with the adviser.

Introducing the Opt-Out process into the existing disclosure framework will be more efficient, significantly reducing the administrative & compliance costs when compared with the Opt-In renewal and ongoing fee disclosure proposal. Furthermore, advising clients of their right to opt-out and right to termination enables clients to fully understand their entitlement to cease the ongoing arrangement where they feel that ongoing advice or services are no longer necessary.

This proposition also reduces the risk that clients are inadvertently or unintentionally opted out of the advice process for failing to return their renewal forms within the required time frame.

Should the reforms however proceed with an Opt-In measure, we can see no basis for including both the annual fee disclosure and the Opt-In requirement given the existing fee disclosure framework already in place.

Recommendation: remove Opt-In and the fee disclosure statement and introduce the Opt-Out process.

3. Retrospectivity

Retrospective legislation can adversely affect existing rights and obligations and as outlined in the Legislative Handbook[9] should only be utilised in exceptional circumstances.

Recognising the significant impact that the proposed reforms will have on the industry, systems and processes, the government has confirmed the prospective nature of key pieces within the proposed reforms in order to provide confidence and stability to a significantly changing regulatory landscape.

The Government has recognised the proposed ban against commissions will 'have substantial impact on the industry' and that it is fair for the changes to apply on a prospective basis and not on a retrospective basis.[10] The government proposes to allow grandfathering of existing contracts (regarding commissions) to ensure that changes apply on a more gradual basis.[11]

We support the prospective nature of the prohibition against commissions. Recognising that the remainder of the proposed reforms will also have substantial impact on the industry and that it is fair and reasonable for the changes to apply on a prospective basis, it is essential for the remainder of the FoFA reforms to apply on a prospective basis also.

We are particularly concerned with ensuring that not only opt-in renewal notices but the annual fee disclosure statement only applies to new clients and that the ban against volume bonuses and other conflicted arrangements only applies prospectively in order to ensure that existing arrangements are not adversely affected. We appreciate that honouring and grandfathering existing arrangements will encompass a degree of complexity when implementing new legislative requirements however it also delivers a degree of fairness (not disadvantaging or adversely affecting existing contractual obligations) and fosters confidence in our government and our legislative system.

We support the prospective application of the proposed reforms and grandfathering of existing arrangements.

Furthermore, it is also essential that the anti-avoidance provision is prospective and does not apply to existing arrangement. The ant-avoidance provision is currently drafted such that it could be administered on a retrospective basis thereby adversely impacting current legitimate arrangements established before the proposed start date. For the avoidance of doubt the effective date of the anti-avoidance provision should be the commencement of the legislation.

Recommendation: the Bill should have prospective application only. No retrospectivity of ongoing fee disclosure (by application to new clients only) or the anti-avoidance provision.

[9] http://www.dpmc.gov.au/guidelines/docs/legislation_handbook.pdf
[10] http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_4
[11] http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_4

4. Future of Financial Advice Commencement Date

The proposed operative date of the 1st July 2012 is quickly drawing near and we are extremely concerned that there will be insufficient time between the finalization of the proposed reforms and the current operative date.

Neither the first nor the second Bill have received legal assent yet and there are still a number of key issues which remain outstanding including the final form of the Best Interest Duty, regulatory confirmation of the **prospective nature** of the ban against volume rebates, commissions and conflicted remuneration, the replacement to the accountant's exemption and findings on the statutory compensation scheme.

It is unlikely that these issues will be finalized before the first quarter of 2012.

Given the scale and the breadth of the reforms there will be significant changes to industry. The current operative date however will not provide adequate time for developing and implementing the necessary compliance frameworks, education and training programs and technology systems to support the new regulatory obligations within the required timeframe.

Recommendation: that the operative date be postponed to no less than 12 months after the legislation receives legal royal assent to provide adequate time for implementation.

5. Other Specific Concerns and Recommendations

In reviewing the Bill we have identified a number of specific concerns and recommendations included below;

- s962A regarding the definition of ongoing fee arrangement: the explanatory memorandum provides that the fee disclosure statements are required where ongoing advice fee is charged 'for a period of **longer than 12** months'. The definition of ongoing fee arrangement in s962A should be consistent with this and define ongoing fee arrangements if a fee is paid **for more than 12 months** rather than 'a period of 12 months or more.'
- s962D – fee disclosure statements if necessary should only apply to new clients from the commencement date of the legislation. Existing clients and arrangements should be grandfathered.
- s962P – advisers incur a civil penalty for charging a fee post termination. There needs to be sufficient time to enable the adviser to undertake the administrative work necessary to implement the termination. We support the inclusion of a grace period of no less than 30 days to provide appropriate period of time to administer the necessary changes.

6. Summary

We applaud the government's objectives of removing red tape and making low-cost good quality advice more accessible. We are however concerned that a number of the key tenets of the Future of Financial Advice, particularly Opt-In, the renewal notice and the annual fee disclosure statement, together with a number of other measures will in fact have the reverse impact. As the administrative and compliance burden increases so too does the cost of advice. This unfortunately is a natural consequence.

To consider the issues proposed in this Bill in isolation from the second Bill and the ultimate impact these issues will have on consumers and their ability to access low-cost quality advice would be detrimental. The government is proposing a number of positive key changes such as introduction of the best interest duty, ban on commissions and increasing ASIC powers which will enhance consumer protection and foster the delivery of quality of advice. When considering the issues for review we encourage the Committee to consider the merits and the necessity of the proposals contained in this Bill in light of the other regulatory reform measures to ensure full consideration of the issues.

It is our view that a number of the key proposals will adversely affect consumers and therefore should be reconsidered.