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Dear Mr. Hawkins,

RE: Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 - Economics Legislation Committee

Thank you for providing this opportunity to comment on the above and related matters that have been referred for examination to the Economics Legislation Committee.

The financial planners and re-sellers of financial products deal with a pool of funds equivalent to the savings held by the banking sector. Due to demographic and workforce trends, this is likely to accelerate over the next decade.

Unlike the banking sector, this sector has not been exposed to the micro level regulatory regime which has drilled into every area of banking process and policy.

The quality of financial advice in general has been distorted by the blurring between purely advisory and sales advice services. As a consequence of the GFC and high profile corporate collapses there appears to be some concern as to the quality of the advice provided and whether planners and re-sellers of products may have been part of the problem.

It has been rightly been argued that a person holding out to provide advice whether designed to conclude a particular sale of a product or not, would be subject to the duty of care principles in law in addition to the laws which govern fiduciaries. In this respect, it is more likely than not that the common law provides the limits as to what sellers and planners can do, and how they exercise their obligations towards their clients – customers. Generally, a person occupying a position of skill, knowledge, expertise and trust has certain duties towards the parties who rely upon this person. There is ample case law, and much discourse in the area of fiduciary duties which encompasses both planners and re-sellers.

The open market much enjoyed till recently for planners and re-sellers had the effect of making financial products accessible and affordable.

Customers' need to pay the income of the financial planner. It was traditionally acknowledged that planners would derive an income from the implementation of the advice, in some form unless the planners had an agreement contrary to this.

The codification, and perhaps extension of the fiduciary duties with the "best interest's duty" at best clears the air but may not add anything new.

A planner holding out to be independent of any supplier of financial products, and not disclosing their remuneration, and therefore acting as a re-seller rather than a planner is likely to be captured by the common law.

The FOFA package of proposed laws was designed to set standards which, in general terms can be found in the common law. The FOFA package was to regulate the sector rather than introduce condition and extension of common law principles. By doing so the FOFA now threatens to regulate well beyond the issue FOFA was initially designed and it may have an adverse impact on both the cost of advice and access to quality affordable advice.

There is some concern whether the proposed Bill will capture unintended parties within the sector. Those engaged in the sale of "banking" products whether from mutual or non mutual banks may be subject to the Bill.

The Bill introduces and extends the regulatory framework to bring back the "best interest" duty and inject much need confidence in the market. Although from a policy perspective this is a good outcome, it will bring about additional regulations upon Authorised Deposit-taking Institutions (ADIs).

ADIs' are required to comply with a large range of regulations from liquidity to capital adequacy to the type of people who manage the affairs of the ADI.

The Bill may increase compliance costs, in turn increase the cost of banking overall. ADIs are currently required to have a range of additional licences delegated to dedicated officers within the ADI. According to the Bill virtually all retail frontline staff would have to fall within the definition of giving financial advice. In virtually every instance the ADI retail officer would need to comply with the best interest's duty test.

It may also expose the ADIs to unintended legal risks.

In the alternative, the cost of implementing the proposed Bill would simple be absorbed by the big four banks, the smaller regional banks will pass on the costs and the mutual sector will need to restructure to maintain their viability. The unintended consequence will be reduced competitive forces in a market already acknowledge as oligopolistic.

The FOFA proposals were designed to deal with market failures, i.e. setting legally enforceable minimum industry standards. It is argued that the failure is not confined to standards it is the recognition that there are two functions within this market the advisers and the sellers. Beyond that there is the banking system. Banks and mutuals traditionally participate in all three sectors. The distinction in both law and in the market is relatively clear, in particular the type of services offered by way of "banking" and the advice received on how best to manage one's financial affairs in contrast to what is available for purchase. The global trend for banks to become one stop shops for all three is of concern, as the public may rightly be confused as to when the bank is selling or advising. Further, as banks tend to profile the intimate details of their customers they are in a unique position to design a strategy to target the advisory and buying needs of the customers. Till date, with a few notable exceptions, the ADI sector has been relatively careful in distinguishing banking from financial advisory and selling activities. The existing ADI regulations deal with these obligations.
For instance the term 'financial adviser' appears to be all encompassing, so much so that many ADIs prohibit their retail staff in providing any advice beyond product information advice.

In this manner the ADIs obligations under the FSR requirements are met, otherwise the ADI is required to provide training and keeping of data as required by the FSR. There is a possibility that the proposed legislation may in fact persuade the ADIs to either pass on the regulatory costs or simple adopt a no advice policy.

It may be that as a policy framework ADIs should be limited from this sector. However, it is likely that the big four will absorb the extra costs, appoint dedicate advisers enhance their position in the market place and on cost alone squeeze smaller ADIs on their margins and in effect their viability. The exemption to basic deposit products may be insufficient in light of the proposed changes to Basel III. The definition of a basic deposit product needs to be reviewed to ensure that "banking" products are dealt with as intended, products used to deposit funds for the purpose of future transactions or as security for intended transactions or as reserves for the deposit. In the alternative it is likely that retail banking staff will be captured by the proposed law. It should be noted that in relation to credit products, the ADIs are currently captured by the National Consumer Credit Protection Act 2009 and any additional regulation would simple increase the cost of banking and reduce competition overall in the banking sector.

The nexus between selling and deciding has to some extent been reaffirmed by the proposed law. There needs to be a clear distinction in the market place that advice comes at a price. The cost of the advice will determine the accessibility of the advice.

There needs to be a perceived value to the advice. In many instances this is done through the design of complex structures and strategies to best meet the needs of the client. There needs to be some legislative pronouncement to distinguish advisers from sellers.

The habit of seeking compensation from bad advice, discovered after markets collapse is a worrying trend, which in the USA has become an industry on its own. The proposed laws may provide too much of a temptation to litigate the losses by identifying potential flaws in the advice based by extension on the proposed laws.

Adviser should not receive any form of benefit other than the fees received for giving the advice. This total ban on receiving any form of payment / benefit will improve the quality of the advice, the overall standards within the industry and will avoid any conflict of interest. The suppliers of the products must also be held accountable as to their marketing and related efforts to promote their product. There needs to be a clear register of interests, and gifts/ benefits which should include the sponsorship of sporting events, seminars and conferences targeted towards advisers. The distinction between informing and selling to the planners requires clarification.

There is an argument that the proposed definition may in effect make some existing incentive schemes especially in the ADI sector not possible. With the obvious need to exempt incentive payments for raising capital, there should be no other opportunity to unduly influence advisers by way of incentives. The current definition may require refinement but should not include any further proposed exceptions.

In relation to the concept of a "financial reward" it is likely that this may ban reward payments for reaching targets or on selling as is increasingly common for bank tellers to engage in. The Bill should not be reviewed in this respect other than to allow planners who do not receive any reward / payment other than providing a planning service receive a bonus for the performance of the investment. In this instance, the client may agree to such payments which may be provided by the suppliers. Beyond this it would create confusion and an opportunity to create fees and rewards where such fees would normally be absent.

The distinction between advisers and planners is probable more sensitive for the private investment firms and larger banks, who have designed complex bonus and reward schemes based on volume, return on client portfolio etc. It is likely that the Bill in its current form will expose such operators. Banks in particular will need to review their entire remuneration structure. Although this will be costly, the fact remains that when a customer is served by a teller, should they also be given financial advice?

The teller has on their screen the client profile so they can easily match up products to on sell, indeed some banks have software to nudge the teller to do exactly this, and reward them through cinema tickets, trips and other rewards. Is the teller selling or advising?

Perhaps the issue is more to do with bank policy and practice. The Bill should confirm the role of the adviser and seller as separate, and for those either acting as an agent of their employer, engage in work which is either advisory or sales but not both.

The manner in which ADI s and in particular larger banks reward their front line staff would probably need to be examined in light of the proposed Bill.

The balanced scorecard approach provide a mix of performance criteria including sales, and compliance issues however, without generating a return on the effort in bottom line terms, the exercise is more of a cost rather than as revenue driver.

In short, ADIs can motivate their staff on issues of compliance without linking them to advisory or sale issues. On this basis the scorecard may be capture by the proposed Bill, and this should be a good public policy outcome. Frontline staff should clearly be rewarded on unambiguous, non interlocking criteria; in short, the score card has the potential to distort the link between sales, and other performance issues. This will compel the ADIs to motivate staff to generate sales and others to refer prospective clients to those staff members.

The clear distinction between sellers and advisers should not be blurred by scorecard mix criteria's techniques. The fiduciary duties in common law are well settled in this regard and the proposed Bill should codify and clarify this position.

On this ground, there should be no exemption to any technique used to generate sales as this will distort the market place. Remuneration based on bonus pool arrangements or any other form of reward linked to sales should be avoided. There is no room to be flexible. People who sell must be clearly identified; the public must know that these people are neither neutral nor dispassionate when putting forward what is on sale. Planners and advisers can also be clearly identified and their fees clearly marked. Any other arrangement whether at a bank branch or business centre has the potential to confuse or complicate what is on offer and within what context. It is understandable that generating sales is the prime driver for every ADI.

It is acknowledged that sharing the fruits of the efforts of the retail front line staff is an important aspect of any workplace arrangement. There are other ways this can be achieved than trying to create intricate and complex measuring tools to pool the benefits of sales for the benefit of the staff.

It's not a matter of splitting staff into those who can earn commissions and those who don't, It's important that planners are not implicated in any arrangement that may influence their decisions. It's not a matter of getting the most of the staff, to deliver the maximum for the shareholders and executives; this is not the objective of the Bill or of the reforms tabled.

The Bill should not be unambiguous as to any form of benefit linked to sales. Infusing total and unequivocal confidence in the market place should be the prime objective of the Bill. The industry has undergone dramatic changes in the past five years, and any form of exemption or small print conditions will fuel speculation in an environment of uncertainty post GFC.

Full fee disclosure is perhaps not as critical as it may first be considered if a split between advisers and sellers is enforced in law.

Consider requiring other re-sellers of services and products to disclose their fees such as travel agents, electrical stores, etc. This is only an issue where the re-seller has also been the adviser-planner. With the effective split between the two functions it will require less regulation and red tape.

It's noted that the Financial Services Guide (FSG) requires advisers to disclose their fees; the question should be why are advisers selling products in the first instance?

If a client is seeking independent advise that is what they should be receiving.

If the client does not wish to pay for the advice, then it's not unreasonable for a fee for service to be underwritten by a fee structure from the product wholesaler.

As long as the client is clear that the advisers are associated with product suppliers, the issue of fees should not realistically be an issue at all. If it were, by extension similar rules should apply to shop assistants advising customers on which TV set to purchase.

In the past, the termination clauses or exit provisions provided an incentive for clients not to terminate. This unfortunate marketing ploy to reduce churning of customers has only added to the less than positive perception of the industry. The client's right to termination in s 962E is a sound policy objective.

In conclusion the overall policy objectives are sound; they are focused on accessible fair and flexible advice.

However, the need to separate the advisers – planners from the re-sellers continues to be blurred.

The policy acknowledges that people will seek advice for free from adviser who in fact are re-sellers. Perhaps a requirement to clearly brand the re-seller would be of benefit to the industry as a whole.

In effect, the fallout of the GFC had highlighted an ongoing issue in the industry, the fine line between advising and selling. A complex set of rules to regulate this aspect of the industry will only increase red tape and the price of the advice and will reduce the accessibility to such advice.

A clear pronouncement that advisers cannot be re-sellers would be a more efficient way to deal with this issue.

More regulation, will only increase the burden on those who can least afford it.

The introduction of the best interest duty, ban on commissions and increasing the powers of ASIC does not comprehensively deal with the issue of *advisors v. sellers*. It does not reduce any confusion or misunderstanding as to what the consumer is buying

The core proposals although good public policy, will ultimately increase the cost of the service, and is more than likely will adversely affect consumers and will not increase efficiency in an industry which is destined to surpass the total funds held by the savings banks in Australia. It's not a matter of more regulation it's a matter of more simple, accessible regulation to provide confidence and less red tape to the industry.

Yours sincerely,

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