22 December 2011

Mr Tim Bryant
Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Mr Bryant,

FSC SUBMISSION – CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 AND CORPORATIONS AMENDMENT (FUTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011.

Thank you for the opportunity to provide a submission to the Parliamentary Joint Committee's inquiry into these Bills.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to discussing the contents with you. If you have any questions regarding the FSC's submission, please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely

CECILIA STORNIOLO
SENIOR POLICY MANAGER

FINANCIAL SERVICES COUNCIL

FSC SUBMISSION

THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

INQUIRY INTO THE CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) Bill 2011 AND CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011

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EXECUTIVE SUMMARY

The Financial Services Council ("**FSC**") welcomes the opportunity to provide comment on the *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* currently before the Committee, are comprehensive reforms which principally amend the Corporations Act and together establish the future financial advice framework for advice providers in Australia.

The FSC has strongly supported the intent underpinning the reforms contained within the two Bills before the Parliament and this Committee which includes improving the quality of financial advice, bolstering trust and confidence in the financial advice industry - ultimately aimed at encouraging more Australians to access more advice.

The FSC also strongly believes in the value that quality financial advice delivers to all Australians who receive it as well as to the Australian economy. KPMG Econtech research commissioned by the FSC showed individuals with a financial adviser saved an additional $1,590 each year (after the cost of the initial advice) when compared to a similar individual without a financial adviser. These savings equated to an additional $91,000 upon retirement for a 30 year old Australian.[1] The KPMG Econtech research also found that if an additional five per cent of Australians received financial advice, national savings would increase by $4.2 billion (or 0.3 per cent of GDP) by 2016-17.

Given the significant value advice delivers, the FSC strongly supports the Government's objective of promoting greater access to financial advice by removing legislative hurdles to enable a scalable advice framework that results in financial advice that is more accessible and more affordable for more Australians. However, to achieve a scalable advice framework which affords Australians the same protections, must allow a financial adviser the legislative ability and certainty to scale the advice and ensure that all advice providers operate within the same legislative framework.

The FSC believes that the following four key measures contained in the two Bills by the Government will have a significant impact right across the financial services value chain. We anticipate these reforms in particular will transform the landscape not only for the financial advice industry but they will also change the way the entire Australian financial services sector will operate in the future.

The FSC notes that these reforms are comprehensive, complex and inter-related and are therefore a package of reforms rather than discrete individual measures. Critically the reforms impact almost all licensees operating a financial service in Australia. Given the complexity and scale of the reform to be implemented with a relatively short timeframe (between legislation passing and the commencement date), the likelihood of unintended consequences are high. A pragmatic and responsive approach from regulators and Government particularly during the

[1] KPMG Econtech, Value Proposition of Financial Advisory Networks Update and Extension, 2011

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early phase of the reforms is necessary to ensure that the objectives of the reforms are not undermined.

This submission is structured to comprehensively express the FSC comments and recommendation in regard to each of the following:

1. **ASIC Powers:** The FSC broadly supports measured enhancements to ASIC powers to enable the regulator to better enforce regulations and maintain consumer confidence in the system.

2. **Best Interest Duty:** The FSC supports the introduction of this foundation measure in the which mean all financial advisers will have a statutory legal obligation to place their client's interests first and above their own. Our submission comments on three fundamental challenges with this measure namely that the duty remains undefined, affords advisers no reasonable steps defense and prevents an adviser from being able to scale advice.

   We submit that this 'best interests' duty combined with another key reform - the removal of conflicted adviser remuneration structures – together ensure the highest level of consumer protection.

3. **Opt-In:** Central to the FSC's position in relation to the proposed adviser charging regime is the fundamental principle that clients who do not seek or receive ongoing advice or services will not pay for them.

   The FSC supports the Government's announcement that the Opt-in renewal notice requirements are to apply every two years rather than annual. Our submission comments and makes recommendations on a number of other challenges with this reform measure in the spirit of enhancing the efficiency and flexibility of the measure to minimise the cost on retail advice clients. Specifically we recommend that the new Fee Disclosure Statement be a prospective requirement and amended to provide retail client with a pertinent summary of the fees and services noting that retail clients already receive the disclosure this measure is attempting to address.

4. **Conflicted Rem:** The FSC supports the measure to remove conflicted forms of adviser remuneration through the banning of commissions which is congruent with fee charging standard of the Financial Planning Association (FPA) and Financial Services Council (FSC).

   Our submission comments and makes recommendations on a number of challenges with regards to the transition of these property rights, namely benefits pursuant to an existing arrangement and about the potential ban on other benefits (investment management fee discounts) which may have the perverse potential of significant distortionary effects including increasing the cost of investment for retail clients and affecting the efficient operation of a highly competitive market.

TRANSITION

Given the breadth of the Future of Financial Advice ("**FoFA")** reforms and their impact across the whole financial services industry, the FSC strongly advocates that transitional arrangements are necessary in order to enable the industry appropriate time to implement the measures once the final form and substance of the legislation is clearly known.

All major financial services reforms have been accompanied by an appropriate transition period – reflecting the need for the industry to undertake major information technology/systems, business process, compliance procedure, (competency) training, disclosure documentation changes and in some cases, amendments to licensing requirements.

These reforms are no different and in our view represent at least as significant a change to the operation of the financial services industry as those introduced by the Financial Services Reform Act 2001.Those reforms commenced on 10 March 2002 and included a two year transition period, ending on 10 March 2004.

We note that the proposed legislation to implement the FoFA reforms has been split into two tranches (Bills) and there exist substantive issues with regards to the provisions contained in both tranches tabled in Parliament (Corporations Amendment (Future of Financial Advice) Bill 2011 ("**Bill 1**") and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 ("**Bill 2**"). In addition, significant regulations supporting the legislation are yet to be drafted and released for consultation. These regulations are critical to ensure that the reforms operate in a clear and effective way.

On the current drafting of the legislation, the majority of measures within the FoFA package (excluding the provisions relating to life risk insurance) are due to commence from 1 July 2012. The FSC is concerned that it is unlikely that the legislation will be passed before the first quarter of 2012. This gives the industry less than six months to develop and implement complex IT systems, compliance frameworks and monitoring processes and education and training programs to ensure that financial services licensees, employees and advisers are aware of and able to meet their statutory obligations. Additionally, the implementation of these reforms will require significant investment and impose costs upon financial services providers of all sizes including small businesses throughout Australia. These costs should only be incurred once the final form of the legislation and obligations are known.

Opt-In Cost Survey

Members have indicated that the cost to build the systems (compliance and information technology) to comply with the FoFA Opt-In reforms will range from $1million – $60million,

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depending on the size of the relevant organisation and the nature of their business activities. Ongoing costs range from $10,000 to $9million, again depending on the size and relevant the nature of their business activities. The total implementing and ongoing costs of the Opt-in reform differs significantly depending on the requirements on the business.

If the information on the Fee Disclosure Statement is summary only (not detailed as per Bill 1) and only applied prospectively, the cost of compliance is 50% cheaper (for the client) than the alternative which is currently required by Bill 1.

Based on a survey of representative advice providers surveyed by the FSC, results show:

	Average cost per client
Summary Fee Disclosure Statement Prospective application of FDS	$ 53.97
Detailed Fee Disclosure Statement Retrospective application of FDS	$ 97.86

Survey of representative FSC FANS – November 2011.

It is also important to recognise that the FoFA reforms are being introduced at or around the same time as a number of other significant financial services regulatory changes , including the Basel III reforms, G-20 reforms (financial services and markets regulation), stronger superannuation reforms, consumer credit reforms, banking competition reforms, insurance capital regime changes, tax agent services reforms, the US foreign account tax compliance law (FATCA) and ongoing AML/CTF requirements.

Timing and alignment of the Future of Financial Advice and MySuper reforms

The FSC notes in particular the importance of coordinated timing and implementation of the reform agenda the government is delivering across the wealth management industry. Harmonisation of legislative requirements (including timing) across FoFA and MySuper is critical.

This is particularly relevant in corporate superannuation where both reforms will heavily impact the financial services sector and its stakeholders, including consumers and their employers. Any inconsistent application of the reform packages in corporate superannuation risks consumer and employer disruption and the proliferation of superannuation accounts.

Examples of transitions periods

Examples of transition periods provided for recent financial services reforms follow below. These examples highlight that it is customary to allow a minimum of 12 months, from the date relevant legislation and/or regulations have been finalised (that is, received Royal Assent), for industry to transition to any new regime.

Critically, an appropriate transition period allows for a prudent and orderly approach to implementation at a time when the entire Australian wealth management industry will be seeking to become compliant. This will place an enormous strain on the industry and the availability of resources from service providers to assist with implementation.

1. FSR reforms

The FoFA reforms are highly complex and impact well beyond the provision of financial advice. As a consequence, the FSC considers these reforms to be at least as significant as those introduced by the *Financial Services Reform Act 2001*. Those reforms commenced on 10 March 2002 and included a two year transition period, ending on 10 March 2004.

2. *Shorter Product Disclosure Statement regime*

Effective from 22 June 2010, the *Corporations Amendment Regulations 2010 (No. 5)* introduced a new disclosure regime for certain financial products. A recent announcement by the Assistant Treasurer and Minister for Financial Services and Superannuation (8 June 2011) confirmed that under transition arrangements for the new Shorter Product Disclosure Statement regime product issuers could remain in the 'old' regime until 22 June 2012. This amounts to a two year transition period from the date the regulations were finalised.

3. Financial resource requirements for Responsible Entities of managed investment schemes

The final Class Order outlining the new financial resource requirements was issued on 7 November 2010. ASIC is providing existing Responsible Entities with almost 2 years (until 1 November 2012) to comply with the new financial requirements. While these requirements are significant, they are not considered anywhere near as complex or wide-ranging as the FoFA reforms.

4. Enhanced Fee Disclosure regime

The Corporations Amendment Regulations 2005 (No. 1) introduced requirements for disclosure of fees and charges in Product Disclosure Statements (PDSs) and periodic statements for most superannuation and managed investment products.

The application of the regime to managed investment products commenced on 1 July 2006, allowing almost 16 months for the industry to transition from the date the regulations were finalised.

Operation of the transition period

In respect of the operation of the transition period, the FSC recommends that the following approach is adopted:

1. Enhanced ASIC powers commence from 1 July 2012;
2. Existing law continues to apply until 30 June 2013; and
3. Providers are permitted to opt-in to the new regime prior to 1 July 2013 at their own discretion; and
4. New law commences from 1 July 2013.

Adoption of this approach has considerable benefits.

Firstly, it ensures that the increased protections that stem from ASIC's enhanced powers are available as soon as possible. The existence of these powers does not affect the readiness or otherwise of the industry to transition to the new regime and hence they should be introduced with immediate effect.

Secondly, it recognises that it will not be possible for licensee providers to be compliant from 1 July 2012. Proceeding with a 1 July 2012 commencement date will result in the vast majority of the financial services industry being unable to provide financial services to existing and new clients as a result of being non-compliant with the reforms.

Ensuring that the existing law continues to apply for a further 12 months provides certainty for the industry and eliminates the need to make selective changes to systems or disclosure documents were instead some aspects of the regime to commence earlier than others. This approach also makes ASIC's role easier by allowing them to focus on developing the necessary Guidance which all providers will need in order to implement the regime rather than focusing on compliance during the initial 12 months.

Finally, this approach recognises that a new entrant into the industry may wish to comply with the new regime rather than adopt the old regime for a period of 12 months. Thus, by allowing such a provider to opt-in to the new regime prior to 1 July 2013 at their own discretion, their costs are minimised.

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SUMMARY OF RECOMMENDATIONS

CHAPTER 1: ASIC POWERS. No recommendations made.

CHAPTER 2: OPT-IN

Recommendation 1	The FSC recommends that the Opt-in measure, including the Fee Disclosure Statement, apply prospectively to new clients.
Recommendation 2	The FSC recommends that the Opt-in measure (Renewal and Fee Disclosure Statement) carve out legacy products including products that are no longer "open" or issued to new members/investors.
Recommendation 3	The FSC recommends that where Division 3 applies, specifically section 962, the above principle should also apply where: (a) the client's ongoing fee arrangement moves between authorised representatives and/or representatives within the same licensee; or (b) where the arrangement moves when an authorised representative or representative moves from one licensee to another; or (c) where the arrangement moves between different licensees and or authorised representatives through i. the sale; or ii. other transfer of a licensee's business to another licensee. (d) Further, and for the avoidance of doubt, it should also apply where the licensee, authorised representative and/or representatives are different but there is a continuation of the contractual terms of the original arrangement.
Recommendation 4	The FSC recommends, given the liability for these arrangements sits with the licensee/adviser, it would be helpful for the Division, or alternatively the EM, to clearly state that the liability for the provision of false information to a third party (e.g. a platform) by a fee recipient in relation to the application of the grandfathering provisions for ongoing fee arrangements rests with the fee recipient/licensee only.
Recommendation 5	The FSC recommends that: • The word 'details' appearing in s962H (2)(c) – (f) be amended from "details" to 'information' or "summary". • s962H(2)(f) be deleted on the basis that the services to be provided as agreed in the ongoing fee arrangement will be the services the client is entitled to receive (as per s962H(2)(e)).
Recommendation 6	The FSC recommends the legislation be amended such that the Opt-In obligations clearly state and apply under terms of fee arrangement where a fee is to be paid ongoing for a period longer than twelve (12) months.

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Recommendation 7	The FSC recommends the remove the requirement in s962A(3)(d) for the personal advice to have been provided before the arrangement has been entered into.
Recommendation 8	The FSC recommends an amendment to: s962G to remove “must, within a period of 30 days beginning on the disclosure day” and insert “at least annually”; and s962K to remove “must, within a period of 30 days beginning on the renewal notice day” and insert “at least once every two years”.
Recommendation 9	The FSC recommends that the Bill be amended such that any recordable means of capturing a consumer’s decision to Opt-In be permissible by law and not limited to “in writing’.
Recommendation 10	The FSC seeks flexibility in the manner in which an adviser can discharge the Opt-in requirements such that an adviser can “give” and “send” documents as appropriate to the circumstances rather than the prescriptive form of the Bill.
Recommendation 11	The FSC recommends that the Bill be amended to provide the adviser a 30 day administrative ‘grace period’ from civil penalty provisions.
Recommendation 12	The FSC recommends that the Bill clearly state the process for the cure of a breach of the Opt-In obligations.
Recommendation 13	The FSC recommends the inclusion of a new interpretation provision in s962 along the following lines: "For the purposes of this Division, if a client who is a natural person dies, the client's estate and any dependants of the client are taken to be the client during a period of six [6] months following the death of the client."

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SUMMARY OF RECOMMENDATIONS

CHAPTER 3: ANTI-AVOIDANCE

Recommendation 14	The FSC recommends that it is essential that the application of the anti-avoidance provision is amended to confirm that it only applies to arrangements or schemes entered into prospectively, from the effective date of the legislation.
Recommendation 15	The FSC recommends that the Explanatory Memorandum(s) be amended to provide clarity to the industry regarding the application and scope of the Anti-avoidance provision.
Recommendations 16	The FSC recommends the anti-avoidance provision should be amended so that it captures: (a) A scheme; (b) In relation to the provision of personal advice to retail clients (c) With a sole or dominant purpose (d) To avoid the application of Division 2 of Part 7.7A in relation to the personal advice (but for permitted exceptions). AND (e) A scheme; (f) In relation to remuneration that is likely to conflict advice to a retail client; (g) With a sole or dominant purpose (h) To avoid the application of Divisions 4 & 5 of Part 7.7A in relation to the remuneration (but for permitted exceptions); AND (i) A scheme; (j) In relation to charging ongoing fees for personal financial advice (k) With a sole or dominant purpose (l) To avoid the application of Division 3 of Part 7.7A in relation to charging ongoing fees (but for permitted exceptions). Importantly, section 965 should not apply to any matter for which there is: i. a carve out in Part 7.7A, ii. grandfathering; iii. carve out in regulations; iv. ASIC relief.

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SUMMARY OF RECOMMENDATIONS

CHAPTER 4: BEST INTEREST DUTY

Recommendation 17	The FSC recommends that the Bill be amended to define the obligation so that a provider has reasonable certainty in relation to what they must do to comply and so that it offers simplicity and clarity in relations to the interpretation, practical application by licensees and advisers but also for enforcement and the courts.
Recommendation 18	The FSC recommends that s961B(2)(f)-(g) be amended and conversely drawn. See recommendation 19 below.
Recommendation 19	The FSC recommends s961B(2) be amended as shown following in tracked form (to the original in Bill 2 at present): ***Proposed changes to Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*** 1. Proposed s 961B(1): *"(1) The provider must act in the best interests of the client in relation to the advice."* 2. Proposed s 961B(2): *"(2) Subject to subsection (3), the provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:* *(a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;* *(b) Identified through instructions, so far as is reasonably possible in the circumstances existing at the time of the provision of the advice:* *(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and* *(ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the **client's relevant circumstances**);* *(c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;* *(d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;* *(e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:* *(i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet*

	those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and *(ii) assessed the information gathered in the investigation.* *(3) The provider will not satisfy the duty in subsection (1), if the provider fails to:* *(~~f~~ a) base~~d~~ all judgments in advising the client on the client's relevant circumstances;* *(~~b~~g) take~~n~~ any other step that a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and having regard to the client's instructions, would reasonably be expected to have taken, ~~be regarded as being in the best interests of the client~~, given the client's relevant circumstances.* 3. The expressions *'reasonably apparent'* and *'reasonable investigation'* are now defined in s 961C and s 961D respectively. 4. Proposed s 961E: *~~"It would reasonably be regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step."~~* 5. Proposed s 961G: *"The provider must only provide the advice to the client if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and having regard to the client's instructions, ~~it would be~~ could reasonably ~~to~~ conclude that the advice is appropriate to the client, had the provider satisfied the duty under section 961B to act in the best interests of the client."*
Recommendation 20	The FSC recommend inserting a provision making it clear that advice can be scoped by a person providing advice through a computer program.

SUMMARY OF RECOMMENDATIONS

CHAPTER 5: CONFLICTED REMUNERATION

GRANFATHERING PROVISIONS	
Recommendation 21	The FSC recommends that s1528(1)(b) of Bill 2 be deleted to enable existing contractual arrangements to be grandfathered. The FSC also recommends that the Bill be amended to enable grandfathered benefits to also be accepted by a financial services licensee, authorised representative or representative of a financial services licensee.
Recommendation 22	The FSC recommends that grandfathering provisions which recognise all existing contractual property rights (irrespective of the provider) should be expressly exempted by legislation.
Recommendation 23	The FSC also recommends that the Bill be amended in s1529 to enable grandfathered benefits to also be accepted by a financial services licensee, authorised representative or representative of a financial services licensee.
INSURANCE RELATED PROVISIONS	
Recommendation 24	The FSC recommends that it is critical that the insurance exemption in s963B(1)(b)(i) for a group life policy for members of a superannuation entity does not capture master policies that permit insurance cover in choice funds taken up by members on a voluntary basis where that insurance is tailored to the needs of the individual member. Section 963B(1)(b) should read as follows: the benefit is given to the licensee or representative in relation to a life risk insurance product other than a life policy for a member of a default superannuation fund (see subsection (2)). Section 963B(2) as drafted should be deleted Section 963B(3) is amended to read as follows: A life risk insurance product is a *life policy for a member of a default superannuation fund* if: (a) the product is issued to an RSE licensee of a registrable superannuation entity, or a custodian in relation to a registrable superannuation entity, for the benefit of a person or persons who are members of the entity that is a MySuper product; and (b) MySuper product has the same meaning as in the Superannuation Industry (Supervision) Act 1993

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Recommendation 25	The FSC recommends the definition of "group life policy for members of a superannuation entity" in section 963B(2) could be expanded to include additional RSE provisions ensuring that non-MySuper RSE's must not default members into insurance arrangements where conflicted remuneration is payable.
OTHER BANNED CONFLICTED REMUNERATION	
Recommendation 26	We recommend that s964 should define the terms used in s964A as follows: (a) "funds manager" means the issuer or manager of an investment product available through a custodial arrangement, excluding an issuer or manager who is in the same wholly owned corporate group as the platform provider (b) "funds manager's financial products" means financial products issued by the funds manager that are held by or through the custodial arrangement by or on behalf of retail clients .
Recommendation 27	The FSC recommends that shelf space fee be defined. The Definition should not be simply any benefit determined by value or number of financial products which effectively catches all benefits including genuine permissible payments.
Recommendation 28	The FSC notes that Division 4 effectively bans conflicted remuneration being paid by a product provider, like a platform operator and from being received by a adviser/licensee. Therefore the FSC recommends that the prohibition in Division 5 section 964A should be amended so that it only applies to a platform provider paying or sharing a volume based shelf space fee with a licensee or representative who provides advice to retail clients
Recommendation 29	The FSC recommends the definition applicable to s964A be expressly narrowed to a fund manager and platform/custodial arrangement. Alternatively, the FSC recommends life risk and general insurance should be carved-out from the ban on volume based shelf space fees (similar to the carve-out for conflicted remuneration).
Recommendation 30	The FSC recommends that the drafting of section 964A(2) be amended to ensure annual or one-off dollar based fees (not related to volume) charged by the platform to the fund manager, that are operational in nature, be expressly carved out from the definition of a volume-based shelf-space fees.
Recommendation 31	The FSC recommends that section 964A(3)(b) be amended to permit rebates paid by the fund manager to a product provider ("platform operator"). This amendment is congruent with Government policy and intent and enables the Australian funds management industry to continue to offer both mandate and pooled investment structures thus maintaining a competitive neutral system.
Recommendation 32	The FSC recommends that section 963A(3)(b) be amended to delete reference to a "scale efficiency test". Further, the section should be amended to permit both mandate discounts and rebates of investment management costs. The section can achieve this

	recommendation by reading as follows: "S964A(3)(b) a discount on an amount payable by the platform operator, or a rebate of investment management fees of an amount paid by the funds manager to the platform operator." The remainder of the section should be deleted.
Recommendation 33	The FSC recommends that s964A be amended to explicitly exempt any benefit that is passed on in full to the end investor to be permissible and not banned under this section. (refer to 6.3.7 below). That is, any volume related benefit payment that flows from a fund manager via a product provider licensee such as a custodial arrangement, superannuation fund or managed investment scheme should be permitted if passed in full to the retail investor without having to prove the benefit met s963A(3)(b) scale efficiency test.
Recommendation 34	The FSC recommends that SIS amendments are necessary to allow differential administration fees to be charged by superannuation fund trustees (who are platform operators) to different members. This will accommodate discounting to members on a volume basis for different dealerships/advisers who have advised those members.
Recommendation 35	The FSC recommends that SIS be amended to permit Trustees to pay benefits given by agreement, consent or authority of the client for advice (fees). See Section 5.5.2 for further information.
INTRA-FUND ADVICE	
Recommendation 36	The FSC recommends that advice fee charging mechanisms apply consistently across FoFA/MySuper reform Bills before Parliament. FSC Recommendation 9 in the MySuper Submission to the PJC states "that the fee definitions should omit personal Intra-Fund Advice as an element which can be cross-subsidised through the MySuper administration Fee".
OTHER CONFLICTED REMUNERATION RECOMMENDATIONS	
Recommendation 37	The FSC recommends that the giving of general advice, for example by providing material or information which is "generally available", should not be advice caught by the far reaching definition of conflicted remuneration.
Recommendation 38	The FSC recommends that s963B(1)(d) be amended by adding "whether directly or indirectly" after the word "given". Alternatively, the provision requires amendment to permit benefits *given by agreement, consent or authority* of the client to the adviser.
Recommendation 39	The FSC recommends that the ban on conflicted remuneration not apply to benefits calculated by reference to benefits that are not caught by the ban. These benefits would be calculated by reference to: (a) benefits not caught by the ban on conflicted remuneration; (b) benefits caught but specifically excluded from the ban on conflicted remuneration; and

	(c) benefits that are grandfathered from arrangements existing prior to the introduction of the reforms.
Recommendation 40	The FSC recommend that the purchase and sale of financial planning businesses as between licensee and its authorised representatives be specifically exempt from s963B.
Recommendation 41	The FSC recommends that the exemption in s963B(1)(c) should be amended to: (a) include a causal link between the advice provided now and the advice provided in the past; and (b) require that it be for past advice given by the relevant representative (and not by any representative of the licensee).
Recommendation 42	The FSC recommends that s963C explicitly carve out non-monetary benefits given by a licensee to their employee – that is authorised representative(s) and representative(s).
Recommendation 43	The FSC recommends that the EM be amended to provide clarity regarding the application of the $300 limit – it not being an aggregate sum but per representative and to include examples of what is and is not deemed to be "frequent or regular" for certainty.
Recommendation 44	The FSC recommends the deletion of s963C(c)(ii). Alternatively, s963C(c)(ii) could be redrafted to read “the benefit is relevant to the provision of financial services or to the conduct of a financial services business;"
Recommendation 45	The FSC recommends that the proposed professional development requirements be included in the regulations not be limited to Australia or New Zealand. The legitimacy of professional development or genuine education or training should be determined by the content rather than the location.
Recommendation 46	The FSC recommends s963C(d)(ii) be amended to read "the benefit is related to the provision of financial services to persons as retail clients;"
Recommendation 47	The FSC recommends that amending the provision s963C(d) to the following effect would permit (carve-out) supply of legitimate goods or services on normal commercial terms to occur without infringing the ban. (a) provided pursuant to an obligation under a contract between the provider and the recipient, where the recipient has in effect paid for it; or (b) payment for a service which the recipient has been contracted to provide, other than a service relating to sale of financial product.

INTRODUCTION

Guiding principles of this submission

In previous submissions to Treasury, the FSC outlined a series of principles which would serve to guide our views on the FoFA reforms. They are:

(a) Reforms should improve accessibility and affordability of advice;
(b) Australians who seek advice are entitled to trust that the advice they receive is in their best interest;
(c) Advisers must place the interests of the client first and ahead of their own interests;
(d) Payments that bias advice should not be allowed to continue;
(e) Reforms should be business model agnostic; and
(f) Reforms should promote competition by ensuring a level playing field between different providers of financial advice.

Importantly, the FSC submits that a key driver of earlier financial services reforms was to address the fact that "financial system regulation was piecemeal and varied, and was determined according to the particular industry and the product being provided. This was seen as inefficient, as giving rise to opportunities for regulatory arbitrage, and in some cases leading to regulatory overlap and confusion."[2]

A further key driver behind earlier reforms was to "put in place a competitively neutral regulatory system which benefits participants in the industry by providing more uniform regulation, reducing administrative and compliance costs, and removing unnecessary distinctions between products."[3]

The FSC remains concerned that the FoFA reforms are failing to observe these two key principles and therefore risk creating a regulatory environment for advice which gives rise to regulatory uncertainty, increased administration and compliance costs, re-creates product distinctions and in doing so eliminates the present competitively neutral regulatory system which facilitates competition.

An example of the FoFA reforms straying from these important principles is the inconsistent approach being taken to the measures which apply to the provision of general advice. For example:

(a) The Best Interest Duty and Opt-In obligation apply to personal advice only which is appropriate and welcomed,

[2] Financial Services Reform Bill 2001, Explanatory Memorandum: http://www.comlaw.gov.au/comlaw/Legislation/Bills1.nsf/framelodgmentattachments/728EAF9DA4B3198CCA256F72002F9F18

[3] Ibid

(b) However, the ban on conflicted remuneration applies broadly to general and personal advice;

(c) ASIC's guidance on scaled advice casts the scope of what it considered general advice (and in particular advice on existing products / intra-fund advice) very widely; and

(d) ASIC's proposed training and assessment framework capture general advice givers within the full competency requirements aimed at financial advisers who engage in personal financial product advice.

1. How to read this submission

Use of text boxes in this submission

The text boxes contain the FSC recommendation for resolving the issues identified. However, even if the Parliamentary Joint Committee on Corporations and Financial Services ("**PJC**") disagrees with our recommended solution, we urge the PJC to consider alternative solutions to the issues identified. If the PJC does not consider that the issues identified are valid, we would ask that additional text be added to the Explanatory Memorandum to clarify the intended operation of the provisions.

Chapters 1 to 6 of this submission contains a detailed analysis of the difficulties that arise in applying the proposed legislation:

2. *Corporations Amendment (Future of Financial Advice) Bill 2011 ("Bill 1"):*

(a) in Chapter 1, we consider the enhanced ASIC Powers;

(b) in Chapter 2, we consider the Opt-In obligations;

(c) in Chapter 3, we consider Anti-Avoidance.

3. *Corporations Amendment (Future of Financial Advice) Bill 2011 ("Bill 2):*

(d) in Chapter 4, we consider Best Interest Duty;

(e) in Chapter 5, we consider Conflicted Remuneration; and

(f) in Chapter 6, we consider the remaining aspects of FoFA which remain outstanding

CHAPTER 1: ENHANCED ASIC POWERS

The provisions contained in Bill 1 relating to the enhancement of ASIC's powers to refuse and revoke licenses and to ban individuals from the financial services industry, have been broadly supported by the FSC.

In previous submissions to the Treasury we have highlighted concerns with the breadth of the measures relating to ASIC's ability to revoke or refuse an Australian Financial Services License (AFSL) or ban an individual.

Given the widening of ASIC's powers, the legislative scheme should ensure that all decisions involving the exercise of those powers should be made after affording affected individuals or licensees an opportunity to appear at a hearing and to make submissions to ASIC, and all decisions should be reviewable by the Administrative Appeals Tribunal and Federal Court.

We welcome the opportunity to work with ASIC to develop the regulations that underpin this regime.

CHAPTER 2: 'OPT-IN' RENEWAL OBLIGATION

The FSC remains of the view that the consumer protection an 'opt-in' policy aims to address (that is, a consumer being charged for an advice service they are not receiving) is in fact achieved through two other measures contained in the FoFA reform package:

(a) The ban on conflicted remuneration – specifically, commissions; and
(b) The best interest duty which carries an explicit duty on an adviser to give priority to the interest of their client's above their own, especially with regard to conflicts such as remuneration.

The FSC has been supported in that view by other stakeholders including ASIC which expressed the same view in its submission to the Parliamentary Joint Commission on Corporations and Financial Services ("**PJC**") in August 2009 as noted by the PJC in its report:

> "ASIC said that the imposition of a legislative fiduciary duty would likely change remuneration practices, even without a ban on commissions."[4]

We note that after an extensive inquiry and over 400 submissions, with regard to remuneration and disclosure, the PJC recommended the following in its report[5]:

> "The committee recommends that government consult with and support industry in developing the most appropriate mechanism by which to cease payments from financial product manufacturers to financial advisers.[6]"

The PJC did not recommend a cessation of asset-based fees, ongoing fees, enhancements to consumer protection nor the introduction of disclosure obligations akin to the 'opt-in' measure now contained in the legislation in its 2009 report.

We note that the 'Opt-In' measure announced by the Government in April 2010[7] was recommended only by the Industry Super Network in its submission to the PJC in opposition of asset-based fees as follows:

> "Where the client and the adviser agree on an asset based fee, this must be agreed and approved by the client at least annually. ISN proposes that clients should opt-in, on an annual basis and in writing, to receive and pay for financial advice."[8]

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[4] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia, November 2009*, page 104.
[5] Ibid.
[6] Ibid, page 127.
[7] The Future of Financial Advice Information Pack Monday 26 April 2010.page 2.
[8] Ibid, page 126 and Industry Super Network, *Submission to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia, (Submission 380),* page 18

The FSC has previously submitted that if a renewal (Opt-In) provision were required (which is effectively an additional disclosure requirement) it should include the ability for a client to opt-out at any time rather than opt-in to continue to receive the service. We assert that this approach would achieve the same level of consumer protection while reducing the cost burden on advisers and administrative burden which is effectively borne by the client in the form of higher advice costs.

As outlined in previous FSC submissions to the Treasury, we believe that an inflexible renewal requirement, as currently proposed in the legislation, is contrary to the best interests of consumers. These provisions will create an unnecessary administrative burden on consumers (and the advice industry) and will shift the risks associated with a changing regulatory, economic and investment environment onto consumers should they inadvertently fail to respond to the opt-in requirements or renew.

We have previously submitted that where an advice service relationship exists between the client and the adviser, the adviser charging regime should be sufficiently flexible so that the client and adviser can agree:

(a) on the advice service/s to be delivered;
(b) the cost of that service; and
(c) the payment mechanism and term for that service.

In an opt-in environment we strongly advocate a renewal mechanism that aligns with the contractual term and nature of the client / adviser relationship. However, a number of provisions contained in Bill 1 will in practice create inflexibility and are far more prescriptive than discussed during the Government's consultation process.

We consider that the proposed provisions will fail to achieve a number of the key policy objectives identified in the Government's previous FoFA announcements in April 2010 and April 2011 including increasing access to, and affordability of, advice and in many cases will in fact be counterproductive to the achievement of those objectives. Some of the Opt-In requirements in Bill 1 are unworkable. This submission aims to highlight some of those issues and recommends amendments to Bill 1 to enable the Government's key objectives to be met.

2.1 OPT-IN APPLICATION AND GRANDFATHERING

Historically, legislative changes, especially those impacting contracts and remuneration, apply prospectively. Further, a number of key reforms in financial services have also carved out legacy products (like whole of life, endowment warrants)[9]. This enables an industry as significant as financial services which manages over $1.8 trillion in Australians' savings to transition into a new regime in an orderly manner. More significantly, this delivers the greatest costs/benefits and certainty for consumers of these services.

On 29 August 2011, the industry welcomed the Government's announcement that the Opt-in measure would apply only to new clients from 1 July 2012.

> "Under the final formulation of the compulsory renewal requirement, if an adviser is to charge an ongoing fee to a retail client, the adviser must provide a renewal ('opt-in') notice every two years to the client, as well as an annual fee disclosure statement including the dollar amount of fees. <u>The opt-in will apply to new clients from 1 July 2012.[10]"</u>

The policy intent and the Government's announcement were reflected in the Exposure Draft of Bill 1 issued for public consultation on 29 August 2011 as follows:

> "Section 962(3): However, this Division only applies where:
>
> (a) the client has not been provided with financial product advice as a retail client by the financial services licensee or the authorised representative before the commencing day; and
>
> (b) the client enters into the ongoing fee arrangement on or after the commencing day.
>
> Section 962 (4): In this section, the commencing day is the day on which this Part commences."

The Explanatory Memorandum accompanying the draft legislation issued on 29 August 2011 for public consultation stated:

> "**Application and transitional provisions**
>
> 2.39 Division 3 (charging ongoing fees to clients) applies only to ongoing fee arrangements entered into on or after the commencing day and where the client has not received financial advice from the licensee prior to the commencing day [Item 13, division 3, section 962(3)].
>
> 2.40 This essentially means that Division 3 (Opt-in) will only apply to new clients."

Treasury confirmed these grandfathering measures as Government policy in the meeting of the FoFA Peak Consultation Group on 9 September 2011.

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9 An example of a law excluding certain products from (what was then) a new fee regime, includes 7.9.16J *Corporations Regulations 2001* (Cth) which excludes from the periodic statement fee requirements certain annuities, risk-only superannuation products and non-investment or accumulation life insurance policies offered through a superannuation fund.

10 The Hon Bill Shorten MP, Media Release 127, 29 August 2011

However, Bill 2 tabled in Parliament on 13 October 2011 differs to the Minister's announcement on 29 August 2011 and corresponding Exposure Draft legislation and Explanatory Memorandum issued for public consultation on 29 August 2011. The Bill tabled in parliament no longer contained the two subsections noted above which effectively achieved the Minister's policy announcement on 29 August 2011.

The current Bill now grandfathers existing clients from receiving the Renewal Notice only (half of the Opt-In obligation) and now requires the *detailed* Fee Disclosure Statement to be issued to **all** clients across all products (including legacy products):

"Subdivision B—Termination, disclosure and renewal

962D Application of this Subdivision

(1) This Subdivision only applies where:

(a) the client has not been provided with personal advice as a retail client before the commencing day by:

(i) in a case where the client has entered into an ongoing fee arrangement with a financial services licensee—the financial services licensee or a representative of the financial services licensee; or

(ii) in a case where the client has entered into an ongoing fee arrangement with a representative of a financial services licensee—the representative or the financial services licensee; and

(b) the client enters into the ongoing fee arrangement on or after the commencing day.

Subdivision C—Disclosure for arrangements to which Subdivision B does not apply

962R Application of this Subdivision

This Subdivision applies to an ongoing fee arrangement to which Subdivision B does not apply.

962S Fee recipient must give fee disclosure statement

(1) The current fee recipient in relation to the ongoing fee arrangement must, within a period of 30 days beginning on the disclosure day for the arrangement, give the client a fee disclosure statement in relation to the arrangement.

Note: This subsection is a civil penalty provision (see section 1317E).

(2) The regulations may provide that subsection (1) does not apply in a particular situation."

The Explanatory Memorandum tabled with the Bill was also changed and now reads that all clients must receive the Fee Disclosure Statement (the other half of the Opt-in obligations) and that the Renewal Notice only applies to new clients:

"**Application and transitional provisions**

1.57 Subdivision B (Termination, disclosure and renewal) applies only to ongoing fee arrangements entered into on or after the commencing day and where the client has not received financial advice from the licensee prior to the commencing day. [***Schedule 1, item 10, division 3, section 962D***]

1.58 This essentially means that subdivision B will only apply to new clients.

Disclosure requirement to all clients

1.55 Fee recipients must, within a period of 30 days beginning on the 12 month anniversary of the day the arrangement was entered into, give the client a fee disclosure statement in regard to all ongoing fee arrangements to which the other disclosure and renewal obligations do not apply. *Essentially, fee recipients must provide fee disclosure notices to all of their clients that they currently have ongoing fee arrangements with, including where those arrangements began or the clients were engaged prior to the commencement day*. ***[Schedule 1, item 10, division 3, sections 962R & 962S***]"

Recommendation 1 **The FSC recommends that the Opt-in measure, including the Fee Disclosure Statement, apply prospectively to new clients.**

Recommendation 2 **The FSC recommends that the Opt-in measure (Renewal and Fee Disclosure Statement) carve out legacy products including products that are no longer "open" or issued to new members/investors.**

2.1.1 Further application of the Opt-in measure

The FSC submits that grandfathering provisions should also allow for the sale or transfer of all or part of an "advice business" without triggering a 'new ongoing arrangement' and without disruption or alteration to the key disclosure obligations or renewal dates.

The following reflects contractual practices that occur today so that the provision is clear in it practical application and not intended to expand the grandfathering intentions as announced by the Government (in its original grandfathering provisions).

Further, the purchase of an authorised representative's register by the authorised representative's licensee under Buyer of last Resort arrangement ("BOLR") (e.g. adviser retires), no services are provided by the licensee and then, that licensee sells the register to another of its authorised representatives, the situation should be considered two "rollover events" similar to Capital Gains Tax so that if grandfathering applied in the original arrangement before BOLR purchase, it should apply to the continued operation of that arrangement with a new authorised representative of the licensee. This should be subject to the arrangements being "substantially similar" and should apply even if the register is divided up and sold to more than one authorised representative of that licensee.

Recommendation 3

The FSC recommends that where Division 3 applies, specifically section 962, the above principle should also apply where:

(a) **the client's ongoing fee arrangement moves between authorised representatives and/or representatives within the same licensee; or**

(b) **where the arrangement moves when an authorised representative or representative moves from one licensee to another; or**

(c) **where the arrangement moves between different licensees and or authorised representatives through**

i. the sale; or

ii. other transfer of a licensee's business to another licensee.

(d) **Further, and for the avoidance of doubt, it should also apply where the licensee, authorised representative and/or representatives are different but there is a continuation of the contractual terms of the original arrangement.**

This position is supported by the Minister's confirmation of the contractual rights advisers (licensees) have to receive ongoing remuneration as follows:

> "Following legal advice from the Australian Government Solicitor, the Government has determined that the ban on conflicted remuneration (including the ban on commissions) will not apply to existing contractual rights of an adviser to receive ongoing product commissions."[11].

From a practical perspective, where a 'grandfathered' ongoing fee arrangement is arranged on, or after, the commencing day via a platform (superannuation or non-superannuation), the platform will be required to administer the grandfathering arrangements based on assurances from the adviser and/or investor in question that the opt-in requirements do not apply to the ongoing fee arrangement.

Recommendation 4

The FSC recommends, given the liability for these arrangements sits with the licensee/adviser, it would be helpful for the Division, or alternatively the EM, to clearly state that the liability for the provision of false information to a third party (e.g. a platform) by a fee recipient in relation to the application of the grandfathering provisions for ongoing fee arrangements rests with the fee recipient/licensee only.

[11] Ibid

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2.2 RENEWAL OBLIGATIONS

2.2.1 Fee Disclosure Statement – disclosure requirements

The FSC is supportive of fee transparency and disclosure of fees paid by consumers for financial services and products.

The FSC has previously recommended and supported the prospective introduction of a simple annual fee disclosure statement to be provided by financial advisers to new clients to enhance consumer understanding of the service and value provided by their adviser. The FSC advocated that such a measure would underpin an opt-out renewal framework thereby balancing the cost with the consumer benefit.

However, in the context of an opt-in framework clients and advisers will be faced with an inflexible, extensive and complicated obligation that may result in unintended consequences for clients and additional costs for advice businesses consequently resulting in higher advice costs.

The FSC does not support the retrospective application of the Fee Disclosure Statement to existing advice clients on the basis that consumers already receive ongoing fee disclosure (albeit produced by product providers like superannuation funds).

The law presently contains fee disclosure requirements including ongoing disclosure (see below) such that the proposed detailed Fee Disclosure Statement requirements will be an additional disclosure requirement and therefore a duplication of costs for advice consumers.

Fee Disclosure requirements

Requirement	When provided	Provider
Financial Services Guide Required to include disclosure on fees an adviser will/can earn directly from a client and related parties.	When giving advice	Licensee/adviser and AFSL Product provider
Statement of Advice Required to disclose all fees earned by the adviser, whom they are paid by and for what - including any conflict of interests	When giving personal advice.	Licensee/adviser
Product Disclosure Statement Required to disclose the fees the client will pay for investing including any advice-related fees which may be debited.	At the point of investing.	AFSL Product provider
Periodic Statement Required to disclose fees debited from the client's account balance (where the advice and product fees are unbundled).	Generally quarterly for managed investment schemes and wraps. Generally semi-annually for superannuation funds.	AFSL Product Provider
Industry standard: FSC Standard 19: ***Advice Fees in Superannuation*** All advice fees charged to a superannuation account must be separately itemised as an "advice service fee" and appear on all superannuation periodic statements.	Ongoing advice fees charged	Licensee/advisers facilitated by ASLF Product Providers.

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Interaction of Opt-In with other Government initiatives

The Government's MySuper Bill[12] will provide further consumer protections against the passive payment of fees for advice services never received. Although perversely, Intra-Fund Advice[13] will legislate that superannuation funds may charge superannuation members a bundled and non-transparent advice fee under the label of "administration fee". The FSC submits that this measure is counter to the policy objectives of the FoFA reforms and in fact codifies the cross-subsidisation and payment of ongoing fees by consumers from their retirement savings for a service they may never access. All other client-directed advice fees must be charged to the superannuation member as a fee for service in the same manner that FSC Standard 19 applies. Once all members' monies are moved to the MySuper environment by 2017 all existing commission payments which are the contractual rights of advisers will cease unless the client has specifically authorised those payments to continue from their MySuper account.

Practical challenges

Further, the FSC considers that there are a number of practical challenges with the prescriptive requirements for the content of the fee disclosure statement. This includes:

a) With regard to s962H(2)(c)-(f) it is unclear what level of "details" are intended to be provided to a client regarding the service agreed to be provided and those actually provided. Given the details of the service agreement will have been articulated at the commencement of the arrangement entering into ongoing fees, it is likely that the service promised will have been delivered as agreed. "Details" implies minutia of information akin to itemisation (for example, itemised phone calls, emails and attendances with details about when they were received, what was discussed etc.). This level of "details" will therefore require greater systemisation (in the form of databases or customer relationship management system) and consequently result in far greater costs of advice that will inevitably be passed on to consumers;

b) It is onerous and unlikely to be useful to specify in the notice, the services that the fee recipient <u>anticipates</u> that the client will receive during the next 12 months (section 962H(2)(f); and

c) Further, the reforms include scope for expansion (or reduction) of the content of the Fee Disclosure Statements without providing further clarity on their application. For example, 962(H)(2)(g) indicates potential scope to

[12] Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011

[13] Intra-Fund Advice is advice provided by a superannuation trustee on advice topics limited to the beneficial interests of the member in that superannuation fund.

include 'details of other proscribed matters' and 962(H)(3)(a) and (b) indicates that under certain circumstances (generally or in a particular situation) that additional or less information may be required to be reported. For licensee providers to be able to comply with (that is implement) the Fee Disclosure Statement, it is necessary for them have a full understanding of all the legal requirements to be imposed (at least initially). Given the examples above and the fact the regulations are still unknown, it is unclear what additional data requirements may need to be contained in the Fee Disclosure Statements and what the specific circumstances are where additional information may be required such that appropriate business rules can be designed and built.

Recommendation 5

The FSC recommends that:

- **The word 'details' appearing in s962H (2)(c) – (f) be amended from "details" to 'information' or "summary".**
- **s962H(2)(f) be deleted on the basis that the services to be provided as agreed in the ongoing fee arrangement will be the services the client is entitled to receive (as per s962H(2)(e)).**

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2.3 OPT-IN OTHER RECOMMENDATIONS (TECHNICAL ISSUES)

The objective of the Opt-In mechanism at its foundation is to ensure consumers who are paying ongoing fees to advisers are aware of those fees and continue to be happy to pay the fees in return for the service they are receiving. Flexibility in the manner in which the consumer is informed of the fees and is able to confirm they are happy to continue to pay the fees is critical to ensuring that on balance, the cost of this protection is commensurate with the benefit it proposes to deliver consumers.

The Minister's policy position with regards to this measure has been stated to be as follows:

> "There will be significant flexibility in terms of how advisers are able to discharge the opt-in obligation. One way for an adviser to renew their services, would be to raise the matter in a face to face meetings….
>
> There will also be flexibility in how advisers construct the disclosure and renewal notices, and the method by which clients can opt-in. For example, the fee disclosure statement is not intended to be complex or lengthy and could be as simple as one page."[14]

The consumer benefits of the Opt-in measure can be further enhanced by correcting a number of operational inefficiencies in the legislation which make the measure inflexible and have the potential to increase the cost of advice for consumers.

2.3.1 Application of the Obligations

The principle of the Opt-In obligations is that it applies when an ongoing fee is charged for a period <u>more than twelve (12) months</u>[15]. That is, the obligation is not intended to capture a single annual charge. However, the Bill contains no measures to support this statement. The Bill states in section 962A(1)(c) that the obligation applies to arrangements where a fee is paid during a period of twelve (12) months or more[16].This is presumably just a drafting anomaly.

Treasury's submission[17] to the PJC restates the two different application terms:

> "The obligations become relevant to ongoing fees which are charged for <u>12 months or more</u>… If an ongoing fee arrangement is to remain in place for a <u>period longer than 12 months</u>…."

Given the current drafting of the Bill, a one (1) year, twelve (12) month, ongoing fee, where an advice client agrees to pay an ongoing fee for service will trigger both the Fee Disclosure

[14] The Hon Bill Shorten MP, Media Release 127, 29 August 2011

[15] Corporations Amendment (Future of Financial Advice) Bill 2011 Explanatory Memorandum paragraph 1.7 and table summary of the new laws, page 6

[16] Ibid, paragraph 1.12 page 8 mirrors the Bill section 962A(1) (c) and says "for a period of 12 months or more".

[17] Treasury Submission, Parliamentary Joint Committee on Corporations and Financial Services, 25 November 2011, paragraph 22, page 4.

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Statement and Renewal Notice. Clarity on the terms of the arrangement are important, particularly because of the addition of the broad Anti-avoidance measure.

Recommendation 6

The FSC recommends the legislation be amended such that the Opt-In **obligations clearly state and apply under terms of fee arrangement where a fee is to be paid ongoing for a period longer than twelve (12) months.**

Payment by Installment

An installment fee arrangement can be the subject of a carve out from the ongoing fee arrangement requirements (s962A(3)). To be covered by the carve out, a number of requirements must be met. A fundamental aspect of this relates however to what is meant by "arrangement" in the context of what is an "ongoing fee arrangement". The arrangement referred to in s962A(3), is the arrangement that would, but for the carve outs, be an ongoing fee arrangement. This would not be the arrangement to provide advice for a set fee, but rather the arrangement to pay for that advice over time (ie 12 months or greater). This is a difficult concept as it is necessary under s962A(3)(d) that the fees payable under the terms of the arrangement have to be reasonably characterised as relating to personal advice given to the relevant person "before the arrangement is entered into". For that to make any sense, it seems that the legislation is envisaging a complex two step process in setting up the arrangements.

The first step would be that the adviser agrees to provide personal advice (and then provides that advice) for a fee that is agreed to and payable at that time by the client. But at that stage there must be no arrangement to pay that fee over a period of 12 months or greater, because that would mean you could never comply with s962A(3)(d) which seems to require that the ongoing element of the arrangement be entered into after the giving of the advice. It could not be realistically suggested that the adviser would provide advice with no agreement that a fee would be paid, when the adviser will have no basis to be compensated for advice after the banning of commissions, other than via the agreement to pay the fee. However, because of the terms of s962A(3)(d), at this stage there could be no ongoing fee arrangement, ie no agreement that a fee will be payable over 12 months or more.

The second step would then seem to be that once you have passed the first step and provided the advice, a second element of the arrangement is entered into namely an arrangement to have the fee in effect extended by what the EM calls a "payment plan". This will then involve payment over a period which on the basis that it is 12 months or greater will normally be an ongoing fee arrangement unless the carve outs in s962A(3) apply.

It seems that if you enter into the arrangements in one step, i.e. the adviser and the client agree that the adviser will provide advice for a fee payable over a period of 12 months or greater, and the adviser then provides that advice, you could never satisfy s962A(3)(d) so that arrangement will always be an ongoing fee arrangement thus invoking the fee disclosure and more importantly the opt in renewal requirements. If this is a correct reading of the legislation, then it would require a very technical and cumbersome procedure for the adviser to enter into the contractual relationship with the client in order to avoid the arrangement becoming an ongoing fee arrangement.

Recommendation 7

The FSC recommends the remove the requirement in s962A(3)(d) for the personal advice to have been provided before the arrangement has been entered into.

2.3.2 Issuing the Fee Disclosure Statement and Renewal Notice

The legislation governing the Fee Disclosure Statement provision is prescriptive and creates an inflexible timetable within which advisers must provide clients with the annual fee disclosure statement. The Bill requires that annual fee disclosure statements "must" be given within 30 days after the 1 year anniversary of the commencement of the arrangement or the last statement being issued (section 962G). Similarly, renewal notices must be given within 30 days after the 2 year anniversary of the commencement or the last renewal notice.

The ability to 'give' a Fee Disclosure Statement to a client during a face to face meeting is a means for ensuring:

1. the client receives the information;
2. the adviser is afforded the ability to explain the information provided; and
3. the cost of complying with this regulatory obligation is kept to a minimum.

The manner in which the Bill has been drafted now means advisers will only have the ability to schedule annual review meetings with their clients with limited flexibility in order to meet these obligations. That is, only those client meetings which are within 30 days of the anniversary date when the client and adviser entered into an ongoing fee arrangement will enable an adviser to 'give' the client the Fee Disclosure Statement in a face-to-face meeting.

Where an adviser holds an annual review meeting with a client during month 11 of the agreement at which a Fee Disclosure Statement is issued and 'given' to the client will not satisfy the adviser's legal obligations. The adviser would be required to re-issue and 'give' the Fee Disclosure Statement to the client again within one month post the 12 month anniversary of the commencement of the agreement or of the last statement being provided in order to meet their obligations.

In our view the Bill should provide reasonable flexibility to align the provision of the Fee Disclosure Statements and renewal notice with advice/client practices such as an annual review meeting.

Recommendation 8

The FSC recommends an amendment to:

s962G to remove "must, within a period of 30 days beginning on the disclosure day" and insert "at least annually"; and

s962K to remove "must, within a period of 30 days beginning on the renewal notice day" and insert "at least once every two years".

2.3.3 Opt-in in 'writing'

The Minister, Treasury and ASIC have stated in a number of different forums that the client ought to be able to opt-in to an ongoing advice arrangement using a variety of 'recordable' means and this objective is supported by the FSC.

Despite the clear policy intent, the Bill does not enable this flexibility. We have previously submitted that the use of the 'in writing' concept, which is a term defined in the law today, should not preclude the use of any means, so long as the renewal can be recorded and verified.

For example, a renewal obtained via a recorded telephone conversation should be permissible as this occurs in a range of client/adviser/product provider interactions at present. Further, future developments of technology such as an Opt-in web (online) or smart phone application for example, are today precluded by the term "in writing".

Recommendation 9

The FSC recommends that the Bill be amended such that any recordable means of capturing a consumer's decision to Opt-In be permissible by law and not limited to "in writing'.

2.3.4 Notices "given" versus "sent"

The Bill creates further inflexibility and confusion through the inconsistent use of the terminology "give" and "send" in relation to the issuing of disclosure statements and renewal notices to clients.

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With regard to the Fee Disclosure Statement, advisers must ‘give’ a fee disclosure statement (s962G) and must ‘send’ a renewal notice and fee disclosure statement (s962K(1)). The FSC has previously sought clarity as to why the terminology is different and how the fee recipient is to discharge the obligation.

Given the inability to charge fees if an adviser has have not given or sent the relevant notices, these obligations should be clarified so that fee recipients can easily discharge their obligations under the legislation. As the intention is to provide flexibility (and therefore lower the cost of this legal requirement for consumers) where documents may be provided at a face to face meeting, ‘give’ is appropriate, although fee recipients will not want to be unable to charge fees if a client has not notified of a change of address, and so it should also be appropriate to discharge the obligation by “sending” the notice to the last known address.

Recommendation 10

The FSC seeks flexibility in the manner in which an adviser can discharge the Opt-in requirements such that an adviser can “give” and “send” documents as appropriate to the circumstances rather than the prescriptive form of the Bill.

2.3.5 Adviser grace period on termination

Additionally, the legislation creates further inflexibility where a client terminates an ongoing arrangement (by direction or by omission). On the current drafting of the legislation, the termination is effective immediately and there is no further ‘grace period’ for advisers to unwind the automatic payment arrangements with product providers. This grace period is a period of time that enables the adviser to:

a) Inform the client of the arrangement’s termination;
b) Inform and instruct any third party to cease payments for fees for advice services;
c) Enable the third party to action/administer the cease payment instructions; and
d) Enable the third party to action/administer the disabling of the service.

The above steps may not be able to occur automatically on the day the client terminates the fee arrangement, whether by direction to the adviser or by omission in responding to the Opt-In renewal notice in the time afforded them by law. As such any adviser, even one who is diligent and with access to the best systems and processes, may still fall foul of section 962P through no fault of their own, resulting in the breach and triggering a civil penalty.

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Example 1:

A client's ongoing fee arrangement has been terminated on Wednesday 16 July 2014. The client was paying the ongoing fee from their bank account by a direct debit authority put in place by the client. The adviser sends a letter to the client and the bank on 18 July 2014 to stop the advice fee payments (note the adviser is not authorised to instruct the bank to stop the payments from the client's bank account). On the 17th of July 2014, the bank pays the adviser one month's advice fee from the client's bank account because the bank is unaware that the client has terminated a service with a third party (in this case the adviser).

Is the adviser in breach of section 962P which states that the fee recipient must not continue to charge an ongoing fee?

Example 2:

A client's ongoing fee arrangement has been terminated on Wednesday 16 July 2014. The client was paying the ongoing fee from their superannuation account by an authority put in place by the client. The adviser sends a letter to the client and the superannuation fund on 18 July 2014 to stop the advice fee payments. On 19 July 2014, the superannuation fund pays the adviser one month's advice fees from the client's superannuation account because the superannuation fund is yet unaware that the client has terminated a service with a third party (in this case the adviser) because the superannuation fund also needs time to administer the cease payment instructions from the client/adviser.

Is the adviser in breach of section 962P which states that the fee recipient must not continue to charge an ongoing fee?

Recommendation 11

The FSC recommends that the Bill be amended to provide the adviser a 30 day administrative 'grace period' from civil penalty provisions.

2.3.6 Cure

It is not clear under the Bill how a breach can be cured. For example, if there has been a failure to provide a notice, it is not clear how an adviser then reset the relationship so that the adviser can start charging fees and providing services again. For example, does the commencement of a new ongoing fee arrangement restart the relationship? Or issue of applicable disclosure documentation, like the reissue of a Renewal Notice?

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Recommendation 12

The FSC recommends that the Bill clearly state the process for the cure of a breach of the Opt-In obligations.

2.3.7 Transitional arrangements on the death of a client

It is not unusual for a single family member to enter into an advice relationship and for that adviser to address estate planning issues. The client may well indicate to family members that on the client's death, the family should contact the adviser for assistance. To avoid disruption to those arrangements when the client dies, we submit that the law should allow a short term transitional period, during which time the estate of the deceased client and other family members, such as the spouse and any dependants, can be treated as falling within the ongoing fee arrangement established by the deceased client. Otherwise, an adviser may be prevented from assisting family members on the death of the client unless those family members enter into a new ongoing fee arrangement. This appears harsh in the circumstances and is likely to be contrary to the wishes of the client. A period of six months is recommended in the following as this is consistent with the processing of estates (to probate for example).

Recommendation 13

The FSC recommends the inclusion of a new interpretation provision in s962 along the following lines:

"For the purposes of this Division, if a client who is a natural person dies, the client's estate and any dependants of the client are taken to be the client during a period of six [6] months following the death of the client."

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CHAPTER 3: ANTI-AVOIDANCE

The purpose of s965, the anti-avoidance provision, is to ensure that no part of Part 7.7A is undermined.

The Anti-Avoidance measure was introduced to Parliament on 13 October 2011 as part of the Bill[18] at the same time the industry was responding to the new measure which was only issued for the first time for public consultation as part of Bill 2.[19]

The industry has a number of concerns about the operation of the Anti-Avoidance measure complicated by lack of consultation on the measure, given the measure's inclusion in Bill 1 and subsequent changes in Bill 2 tabled in Parliament.

3.1 Scope

Further, the scope of the application of section s965 is complicated by the uncertainty regarding how this provision interacts with any arrangements already entered into (or entered into prior to 1 July 2012) and with any grandfathering provisions which the Government may provide.

Specifically, the wording of s965 does not exclude existing arrangements which may inadvertently capture legitimate, and legally binding, arrangements already entered into. The problem is that the provision applies to the carrying out of a scheme without clearly indicating that schemes commenced before a specified date or grandfathered, will be excluded from the application of the section.

Recommendation 14

The FSC recommends that it is essential that the application of the anti-avoidance provision is amended to confirm that it only applies to arrangements or schemes entered into prospectively, from the effective date of the legislation.

The applicability of anti-avoidance provisions in the context of legislation such as the GST Act or Income Tax Assessment Act requires, broadly a nexus between a specified "benefit" (defined for the purposes of the relevant legislation) in relation to the relevant "scheme" (also defined for the purposes of the relevant legislation).

However, the proposed anti-avoidance provisions contained in the FoFA Bill do not require any type of benefit to be derived in relation to the scheme (not defined for the purposes of Division 6). This is not consistent with the threshold conditions typically required before an anti-avoidance provision will apply in the context of other legislation. Moreover, the scope of other anti-avoidance provisions are appropriately limited to a benefit relevant to the subject matter

[18] Corporations Amendment (Future of Financial Advice) Bill 2011

[19] The Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 was issued for public consultation on 28 September (submissions were due 19 October 2011).

regulated by the relevant legislation e.g. tax benefits are required before the anti-avoidance provisions of the Income Tax Assessment Act are triggered.

We also note that no guidance is provided regarding the factors to be taken into account when determining whether the requisite “sole” or “for a purpose (that is not incidental)” purpose test is satisfied.

It is also not clear to which person the “sole” or “for a purpose (that is not incidental)” can be attributable e.g. is a relevant purpose the purpose of any relevant tax adviser to a licensee?

Another key term “scheme” remains undefined therefore unclear for the industry. It is also unclear how the “sole” or “for a purpose (that is not incidental)” test works in relation to “part of a scheme”. If the scheme can be broken down into “parts” that are not discrete stand-alone components, and the purpose test applied to any of those parts, it is unclear how the purpose test is truly a “sole” or “for a purpose (that is not incidental)” test when the element can be satisfied in relation to an arbitrarily determined “part” of the scheme. To resolve these issues, the anti-avoidance provisions should apply only where the scheme attempts to circumvent the policy objectives of Part7.7A.

These policy objectives should be identified in the relevant Explanatory Memorandum (“EM”). However, both EMs are brief and do not afford any clarity as to the purpose and scope of the provision.

The provision is exceptionally broad and appears to cover possible future application of the Part.

Recommendation 15

The FSC recommends that the Explanatory Memorandum(s) be amended to provide clarity to the industry regarding the application and scope of the Anti-avoidance provision.

Following is the industry’s recommendation provided to Treasury regarding the Anti-Avoidance provision in its submission in response to Bill 2 which Treasury did not receive before the Anti-Avoidance provisions were tabled in Parliament:

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Recommendation 16

The FSC recommends the anti-avoidance provision should be amended so that it captures:

(a) A scheme;
(b) In relation to the provision of personal advice to retail clients
(c) With a sole or dominant purpose
(d) To avoid the application of Division 2 of Part 7.7A in relation to the personal advice (but for permitted exceptions).

AND

(e) A scheme;
(f) In relation to remuneration that is likely to conflict advice to a retail client;
(g) With a sole or dominant purpose
(h) To avoid the application of Divisions 4 & 5 of Part 7.7A in relation to the remuneration (but for permitted exceptions);

AND

(i) A scheme;
(j) In relation to charging ongoing fees for personal financial advice
(k) With a sole or dominant purpose
(l) To avoid the application of Division 3 of Part 7.7A in relation to charging ongoing fees (but for permitted exceptions).

Importantly, section 965 should not apply to any matter for which there is:

i. a carve out in Part 7.7A,

ii. grandfathering;

iii. carve out in regulations;

iv. ASIC relief.

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CHAPTER 4: BEST INTEREST DUTY

The foundation measure proposed in the Future of Financial Advice reforms is the introduction of a 'best interests' duty which aims to elevate the industry to a profession by imposing a legal obligation on all financial advisers will have a legal obligation to place their client's interests first and above their own.

This 'best interests' duty combined with another key reform the removal of conflicted adviser remuneration structures – together ensure the highest level of consumer protection. Central to the FSC's position in relation to the proposed adviser charging regime is the fundamental principle that clients who do not seek or receive ongoing advice or services will not (and should not) pay for them.

The Financial Services Council supports the imposition of a positive statutory best interest duty on advisers to act in the best interests of consumers when providing personal advice to retails clients and to give priority to the interests of those clients in the event of a conflict of interest. In line with other professions and the introduction of the best interest' obligation in other jurisdictions like the UK and USA, the duty not should not be so broad as to impose a duty higher than any other profession or occupation in Australia or internationally.

The FSC has made numerous submissions to Treasury regarding this fundamental and significant measure. Specifically the FSC has advocated the introduction of a defined 'best interests duty" (to mean that a financial advisers must act in the best interests of their client and to give priority to the interests of the client in the event of a conflict of interest) in order to provide consumer and advisers with certainty.

Without a clearly defined best interest duty with appropriate clarification in the law and guidance outlined in the EM, advisers can meet all other FoFA requirements yet still be open to pernicious law suits. Without a defined duty and non-exhaustive conduct steps, Professional Indemnity ("**PI**") insurers will become cautious for years (whilst the new duty is tested in the courts) during which time – costs of PI cover will remain high (higher than current costs) thereby increasing the cost of advice for Australians without any commensurate consumer protection.

4.1 Summary of the Best Interest Duty

In summary, to comply with the duty, a provide must:

- Act in the best interest of the client (s961B(1));
- Comply with 7 broad principles based steps conduct requirements (s961B(2));
- Take an additional ("catch all") conduct step which would reasonably be regarded as in the client's best interest as determined by one of reasonable level of expertise and exercising due care (s961E);
- give appropriate advice (s961G), including continuing to comply with "know your client" and "know your product";

- provide additional disclosure requirements (s961H); and
- prioritise the interests of the client where the provider knows or reasonable ought to know before the interests of the:
  - advice provider;
  - licensee or authorised representative; or
  - associate of the provider; or
  - associate of the authorised representative or licensee.

4.2 Best Interest Duty and Reasonable Steps

We note that section 961B(1) of Bill 2 imposes the general obligation on the provider without defining the duty. The ambiguity of the duty is further complicated by conduct step (s961E) and which hinges on the adviser acting in the client's 'best interest'.

The duty is supplemented by s961B(2) which sets out a series of steps – essentially a process, which the FSC largely welcomes except for s961B(2)(g) which leaves the steps open-ended thereby creating ambiguity about other reasonable conduct/steps a provider must take in order to comply with the duty.

Moreover, whilst the steps in s961B(2) are largely congruent with, they are **additional** to the duty an adviser owes their client under common law fiduciary obligations (profit and conflict rules) and at contract law (and torts). As such advisers will operate under a number of, each slightly nuanced, disparate legal 'best interest' obligations which adds to the complexity and cost of the regime.

Moreover, given that the term "best interests" appears in other legislative contexts e.g. section 52(2)(b) of the SIS Act and Section 181 of the Corporations Act there remains the potential for some degree of confusion or for incorrect assumptions to be made regarding its meaning in this context. Alternatively, the courts may interpret the duty on the outcomes of the advice process that is as a "best advice" obligation, which is not only an impossible and unreasonable test for an adviser to defend but also contrary to the Government's stated policy that:

> "the focus of the duty should be on how a person has acted in providing advice rather than the outcome of that action".[20]

[20] Future of Financial Advice Information Pack 28 April 2011, page 12.

Recommendation 17

The FSC recommends that the Bill be amended to define the obligation so that a provider has reasonable certainty in relation to what they must do to comply and so that it offers simplicity and clarity in relations to the interpretation, practical application by licensees and advisers but also for enforcement and the courts.

Both Government announcements in April 2010 and April 2011 stipulate that the best interest duty would include "a reasonable steps qualification, so that advisers are only required to take reasonable steps to discharge the duty"[21] and "are not expected to base their recommendations on an assessment of every single product available in the market"[22].

Notwithstanding this, Bill 2 does not provide a reasonable steps defence. An advise provider will have significant practical challenges in positively proving, as required by the provisions, that the provider "based all judgements in advising the client on the client's relevant circumstances" (s961B(2)(f). It would also practically challenging for the provider to positively prove that the provider had "taken any other steps that would reasonably be regarded as being in the best interests of the client" (s961B(2)(g)). As these two obligations are non-exhaustive and involve interpretative professional judgement which reasonable minds may differ in their interpretation.[23]

The FSC submits that s961B(2)(f) –(g) as drafted place an unreasonable duty of proof on a provider. If these duties were drafted conversely, to read what a provider must not do, this would enable identifiable allegations to be made and the provider would then be able to know which reasonable particularity the nature of the allegation and what they must refute in the event of failure. This is a well-established common law requirement[24] under which other professions for example operate under.[25]

Recommendation 18

The FSC recommends that s961B(2)(f)-(g) be amended and conversely drawn. See recommendation 19 below.

Moreover, the relevant statutory standard to be observed should be determined by reference to the tasks or conduct that the financial adviser is engaged to perform. In a statutory context, some judicial recognition of this principle is reflected in decisions such as Vines v ASIC [2007] NSWCA 75 in the context of director's duties.

[21] Future of Financial Advice, Information Pack 28 April 2011, page 12
[22] Future of Financial Advice, Information Pack 26 April 2010, page 5
[23] See Appendix 2 to the Financial Services Submission to the PJC December 2011.
[24] *Kirk V Industrial Court (NSW) (2010) 239 CLR 531 at 557.*
[25] Op Cit.

Further, the duty(s) as stipulated requires an adviser not only to consider all products available in the market, but to consider products in respect of which the adviser may not be licensed, authorised or competent to assess and or recommend. We do not believe that was the intention of the previous policy statements made by the Government.

4.3 Scalable advice

The FSC strongly believes in the value that quality financial advice delivers to all Australians who receive it as well as to the Australian economy. KPMG Econtech research commissioned by the FSC showed individuals with a financial adviser saved an additional $1,590 each year (after the cost of the initial advice) when compared to a similar individual without a financial adviser. These savings equated to an additional $91,000 upon retirement for a 30 year old Australian.[26] The KPMG Econtech research also found that if an additional five per cent of Australians received financial advice, national savings would increase by $4.2 billion (or 0.3 per cent of GDP) by 2016-17.

Given the significant value advice delivers, the FSC strongly supports a scalable advice framework that results in financial advice that is more accessible and more affordable for more Australians. However, to achieve this, a fundamental principle of the scalable advice framework must be regulatory certainty and clarity for both licensees and financial advice providers. The financial advice industry must be able to have confidence in the regulatory framework. Providers of advice and their clients should be able to limit the scope of the advice service to be provided by agreement. This clarity will enable clients to better select the advice level they desire and to better manage the cost which they will pay for advice.

An ability to legally limit the scope of an adviser's investigations, without limiting nor contracting out their legal 'best interest' duty to their client, will ensure that more Australians are able to access advice. That is, the ability to access more affordable piece by piece advice from a financial adviser legally able to provide it.

The FSC has welcomed the Government's intention to provide greater access to affordable advice for more Australians.

> 'The delivery of scaled advice is critical to achieving the Government's objectives of promoting greater access to financial advice. This Government is committed to providing advisers with certainty of how to provide this form of advice in a way that meets their regulatory obligations,'[27]

However, the FSC notes that the only type of scalable or piece by piece advice an Australian consumer will be able to access will be limited to Intra-Fund Advice (see chapter 6.4) provided

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[26] KPMG Econtech, Value Proposition of Financial Advisory Networks Update and Extension, 2011
[27] Minister Shorten MR164 "Improving Access to Simple Financial Advice", 8 December 2011.

by a Superannuation trustee (or related advice licensee) and the advice will be limited to the superannuation member's account only.

Whilst this type of scaled advice may enable more single issue advice to be provided to Australians limited to advice on their specific superannuation (fund) interests only, reforms have fallen short of delivering the outcomes Australian's deserve – which is to receive non-conflicted advice by a professional financial adviser acting in their best interest.

> "The Government has acted to remove the regulatory barriers to the provision of simpler forms of financial advice by ensuring that financial services providers, including financial planners and superannuation funds, can provide single issue or 'scaled advice' while still meeting their regulatory obligations. The provision of scaled advice will increase access to advice and open up new consumer segments to the industry[28]".

Contrary to the Minister's statement and to other professions, as Bill 2 does not permit an adviser to act on the client's instructions nor does it permit the client and the adviser to agree on the scope of advice subject matter whilst still acting in the best interest of the client, Bill 2 has failed to create a level playing field for "other forms of financial advice[29]". The creation of a separate class of advice related to a member's interest in their superannuation fund (known as intra-fund advice) will therefore give rise to regulatory arbitrage and an uneven playing field between financial advisers regulated under the FoFA reforms and superannuation fund trustees and related service providers.[30]

Clear express statutory recognition of the ability to scale or scope the advice subject matter is what enables an adviser to focus their advice investigation to the area(s) the client has identified, instructed or agreed they want the advice to address and therefore curtail the cost of providing the advice.

> Example 1
>
> Client contact their superannuation fund and says they have won $10,000 and asks if they "can put the money in my super". The superannuation fund is permitted by the proposed Intra-Fund Advice measures to provide the client with personal advice. However, the superannuation fund is not permitted to consider advising the client on matters beyond the member's superannuation fund (sole purpose test). Therefore the superannuation fund responds that yes, the client can put the money in their super fund, despite the fact the member may have credit card debit or a mortgage or other financial needs.
>
> Outcomes: the client has received legally complying Intra-Fund Advice which is single Issue piece by piece (and paid by the client from their administration fees).

[28] Ibid.
[29] Op Cit.
[30] Op Cit.

Example 2

This client this time goes to see their advice provider and asks the same question. They Have won $10,000 and ask if they "can put the money in my super". The drafting of Bill 2 will require the adviser to consider and investigate (make inquiries) into the client's overall objectives, financial situation and needs before they can provide advice – even if the client says that they only wish to consider that specific scenario – because the duty rests with the advice to do so. It is also unclear what obligations an adviser may have with the client once the advice is delivered. For example, the adviser determines that its in the best interest of the client to use the monies to pay off their credit card debit. If the client determines, regardless that they want to add the moneys to their superannuation account – is the adviser permitted to execute the client's request given the adviser has determined that course of action is not in the client's best interest?

Outcomes: The client will have received comprehensive advice which is in their best interest at commensurate cost.

The examples above are simplistic in nature but highlight that the Best Interest Duty obligation and the Intra-Fund Advice measures within Bill 2 and the MySuper legislation create two very different advice regimes with two disparate sets of duties and no level playing field for the different types of advice providers.

Further amendment is required to s961B(2) to expressly provide the ability to scale advice.

The FSC recommends the following amendments to the Best Interest duty which aim to provide legal simplicity, certainty and enable scalable advice without compromising the legislative and policy objectives.

Recommendation 19

The FSC recommends s961B(2) be amended as shown following in tracked form (to the original in Bill 2 at present):

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

1. Proposed s 961B(1):

"(1) The provider must act in the best interests of the client in relation to the advice."

2. Proposed s 961B(2):

"(2) Subject to subsection (3), the provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:

(a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;

(b) Identified through instructions, so far as is reasonably possible in the circumstances existing at the time of the provision of the advice:

(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and

(ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the ***client's relevant circumstances****);*

(c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;

(d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;

(e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:

(i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and

(ii) assessed the information gathered in the investigation.

(3) The provider will not satisfy the duty in subsection (1), if the provider fails to:

(~~f~~ a) base~~d~~ all judgments in advising the client on the client's relevant circumstances;

(~~b~~ g) take~~n~~ any other step that a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and having regard to the client's instructions, would reasonably be expected to have taken, ~~be regarded as being in the best interests of the client~~, given the client's relevant circumstances.

3. The expressions *'reasonably apparent'* and *'reasonable investigation'* are now defined in s 961C and s 961D respectively.

4. Proposed s 961E:

   ~~*"It would reasonably be regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step."*~~

5. Proposed s 961G:

   "The provider must only provide the advice to the client if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and having regard to the client's instructions, ~~it would be~~ could reasonably ~~to~~ conclude that the advice is appropriate to the client, had the provider satisfied the duty under section 961B to act in the best interests of the client."

4.4 Providing scalable advice via a computer program

The Bill as currently drafted will not allow personal advice to be provided by way of a computer program and therefore does not allow for the provision of a broad scaled advice regime via the internet.

The Bill and Explanatory Memorandum clearly contemplate facilitating the provision of personal advice through a computer program. We welcome this initiative as we believe it will facilitate low-cost limited advice that will be made accessible to a large number of Australians who may not otherwise have been able to afford personal advice.

However there are a number of issues with the drafting that need to be addressed in order to ensure that the provisions operate as intended.

The FSC submits that for more people to be able to access quality, affordable advice it is crucial that advice be able to be provided through various mediums (including electronic). The current drafting of s961(6) clearly recognises this. However the current best interests duty drafting only allows advice to be scaled by the client which is not possible where the client is accessing advice online through a computer program. Some of the issues include:

- <u>A computer program cannot comply with a broad undefined duty to act in the best interests of clients</u>. A computer program needs parameters by which to operate and given it is not clear what this duty means a computer program will have no ability to comply with it.

- <u>Where advice is being provided through a computer program, it must be possible for the computer program to be able to scope the advice</u>. Provided through various mediums (including electronic) is crucial for more people to be able to access quality advice and it is clear that the current drafting of s961(6) recognises this. However, the current best interests duty only allows advice to be scaled by the client, which is incompatible where the client is accessing advice online through a computer program.

  A computer program needs to operate within agreed variables and permutations. So the program needs to be able to specify what it can provide advice on and what it won't provide advice on. As such, the provisions in all of section 961B need to only apply to that limited scope of advice and nothing broader.

- <u>A computer program is unlikely to be able to determine whether any information entered by a client is inaccurate</u>. Nor can the program determined if a client's objectives, financial situation and needs are incomplete. So we do not know how the obligation to make inquiries to ensure the information is complete and accurate can be complied with, particularly given the definition of "reasonably apparent" in section 961C.

- <u>A computer will not always be able to determine whether it is reasonable to consider recommending a financial product</u>. Nor is it clear how broad a range of products the computer program needs to consider to satisfy this obligation, which quickly becomes unworkable if the program needs to take into account the various intricacies a number of products. To truly facilitate the provision of affordable limited advice that recommends specific financial products through a computer program, we believe that the client and the program need to agree that the product selection, if appropriate, will be limited to just one or a handful of products.

- A computer program cannot take any other step that would reasonably be regarded as being in the best interests of the client. The difficulty is further amplified by the uncertainty around what "best interests" means and its role in determining the scope of advice to be provided.

Recommendation 20

The FSC recommend inserting a provision making it clear that advice can be scoped by a person providing advice through a computer program.

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CHAPTER 5: CONFLICTED REMUNERATION

We support the introduction of a prohibition of <u>those</u> monetary benefits that conflict advice as outlined by Minister Shorten in the "Future of Financial Advice Information Pack" released in April 2011.

However, the proposed provisions are broad in their application and go beyond the scope of the key policy objectives identified in that announcement, and in many cases will be counterproductive to the achieving the desired objectives.

The breadth of the application of this legislation is compounded by the manner in which the provisions in Divisions 4 and 5 are drafted. That is, the legislation does not stipulate what is permitted and what is not, rather it is principles-based, casting a very wide net and establishes statutory presumptions[31] that certain benefits are conflicted thereby requiring the Licensee (critically, not limited to an advice Licensee) to prove their actions are lawful.

Whilst we understand the intent behind this approach is to ensure beyond doubt that all conflicted benefits are captured, the impact of casting so broad a net means that 'benefits' which are neither conflicted nor paid to an adviser are also caught within the ban.

This principles-based approach will therefore necessarily give rise to significant compliance costs and uncertainty.

To address these concerns, this submission outlines key amendments to enable Australian financial services Licensees (such as fund managers and other product providers) to continue to operate efficiently and with regulatory certainty without compromising consumer protection outcomes.

5.1 Grandfathering Division 5

The FSC submits that appropriate grandfathering of existing arrangements is a fundamental principle underlying the implementation of any reforms, particularly reforms that are as broad and profound as these. We welcome the following comments made by the Ministers on the second reading of Bill 2 in Parliament:

> "Finally, while these measures around remuneration are important, they represent a large change to the industry and to individual businesses."

Further, the FSC welcomed policy announcements by the Minister via media release on 29 August 2011 acknowledging the *"existing contractual rights of an adviser to receive ongoing product commissions",* restated again in the Minister's second reading of Bill 2 in Parliament:

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[31] Bill 2 EM, paragraph 2.16, page 27.

> "It is for this reason that existing trail commission books will be `grandfathered'. This means that commissions from business entered into prior to the reforms can continue. Of course, commissions on new business and clients after 1 July 2012 will not be allowed."

Grandfathering provisions applicable to Division 4 – Conflicted Remuneration, are contained within Bill 2 at a new section 1528. However, in contradiction with the Minister's statement, this provision expressly bans all monetary and non-monetary conflicted remuneration including "existing trail commission books" on business entered into **prior** to 1 July 2012 which is given by a product provider ("platform operator").

It is and has been industry practice that product providers ("platform operators") 'give' these benefits to advice licensees. Therefore, section 1528(1)(b) expressly prohibits the giving of benefits for arrangements (commissions) that exist prior to the commencement of this Bill. This amounts to a retrospective ban on conflicted remuneration paid by platforms. This is inconsistent with all previous policy announcements on this matter.

Further, in order to be effective, any grandfathering of existing arrangements will need to enable a licensee, an authorised representative, or the representative of a licensee to accept these benefits – not simply for the provider to be permitted to 'give' these benefits (as is the case under the present grandfathering provisions).

Recommendation 21

The FSC recommends that s1528(1)(b) of Bill 2 be deleted to enable existing contractual arrangements to be grandfathered.

The FSC also recommends that the Bill be amended to enable grandfathered benefits to also be accepted by a financial services licensee, authorised representative or representative of a financial services licensee.

Whilst it appears that regulations may be made to prescribe circumstances where these benefits may continue to be given (grandfathered) under s1528(2)(a), the effect of section 1528(2)(b) is to exclude an exemption for product providers payments ("platform operators") being introduced via regulation.

As a result, the only available mechanism to provide appropriate grandfathering of product provider payments ("platform operators") is via a legislative amendment to section 1528 – namely the deletion of paragraphs 1528(1)(b) and 1528(2)(b).

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Recommendation 22 **The FSC recommends that grandfathering provisions which recognise all existing contractual property rights (irrespective of the provider) should be expressly exempted by legislation.**

The FSC submits that similar contractual rights also exist for arrangements relating to volume related payments between product providers, trustees, platform providers and licensees and that these existing arrangements must be similarly grandfathered in light of these contractual property rights.

Grandfathering provisions applicable to Division 5 – Other Conflicted Remuneration are contained in section 1529. Whilst s1529 may grandfather these benefits given under an arrangement prior to the commencement of this Bill, they are still caught by the ban because a Licensee, including a superannuation fund does not have a corresponding grandfathered right to 'accept' the benefit (caught by the ban in Division 4).

Recommendation 23 **The FSC also recommends that the Bill be amended in s1529 to enable grandfathered benefits to also be accepted by a financial services licensee, authorised representative or representative of a financial services licensee.**

5.2 Insurance-related provisions

The Government first announced a ban on up front and trailing commissions and like payments for both individual and group risk insurance within superannuation in its Future of Financial Advice policy announcements in April 2011. There were no corresponding recommendations made by the PJC nor did the Government's initial introduction of the Future of Financial Advice reform package in April 2010 contain any recommendation on banning commissions in insurance.

On 4 August 2011, Minister Shorten made comments in an address to delegates at the FSC Conference, that the Government was reconsidering the announced ban on risk commissions inside superannuation and was more persuaded by the argument against the proposed commissions ban in certain cases such as where there has been work by an adviser that had gone into acquiring the product on behalf of an individual. The Minister stated that he did not see the case for commission on insurance through default or group policies, but noted that he was open to propositions around individually advised risk products in super.

The FSC has continually supported the principle that consumers should not pay for financial advice services that they do not receive. Therefore, the FSC supports the measures to ban commissions on insurance being paid by superannuation fund members where they are members of a default fund (for example a MySuper member) and are therefore unlikely to have received individual personal advice from a financial adviser on their insurance arrangements within that fund.

However, the FSC does not support the measures contained in the second FoFA Bill before Parliament that prohibit commissions on group life insurance in superannuation within a 'choice' superannuation fund.

The FSC supports choice for consumers in how they pay for life insurance advice where they make a choice to receive it – regardless of where and how the insurance policy is administered and held. The FSC submits that commissions should continue to be permitted for financial advice in relation to voluntary ('choice') group insurance (e.g. tailored, additional or top-up cover inside a non-default superannuation fund)

This approach will ensure consistency across the market regardless of whether a consumer proactively seeks advice about their life insurance needs through superannuation or directly via an adviser. It will also ensure that members of a superannuation fund who seek to access adequate levels of insurance appropriate for their individual circumstances are not disadvantaged unnecessarily through increased cost and complexity of administration.

We acknowledge that the policy rationale for the measure to ban commissions on all group insurance arrangements is based on an assumption that members with a group life policy are likely to be disengaged and have not actively made a decision in respect of their insurance or received individual advice in respect of their insurance options. However, we submit that the

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distinction between "individually advised" and "group life policies" held within superannuation is misconceived and will result in unintended consequences for superannuation members.

As previously submitted in the FSC's response to the FoFA Tranche 2 Exposure Draft legislation, many group insurance policies inside superannuation, which are not attached to a default employer superannuation fund like MySuper will become from 1 July 2013, are able to offer individually advised and tailored policies (including product types, sum insured, individual underwriting etc.) under a single contract with an insurance provider via a group (master) policy.

This means that the individual member can receive a tailored insurance solution based on advice from their financial adviser, but for efficiency reasons the trustee of the superannuation fund holds a group master policy with the insurer under which each member applies for their tailored insurance cover. These policies also ensure that members can receive the benefits of insurance negotiated at a 'group' level, including lower premium costs.

In other words, the use of a group insurance policy simply reflects the legal vehicle for the delivery of insurance to members of a superannuation fund. It does not determine whether a member has received individual advice and elected to make choices about their insurance cover.

The definition of a group life policy for members of a superannuation entity in Section 963B(2) of the Bill tabled in Parliament on 24 November 2011, captures arrangements outlined above under the definition of group policy, creating an artificial distinction between:

(i) A policy established within a superannuation fund, where the member has entered into an individual contract with the insurance provider for each policy held but is administered by the RSE (i.e. facilitates administration of the policy including premium payment). **The legislation allows commission to be paid on this policy.**

(ii) A master/group policy established with a fund, where the RSE trustee has entered into a single contract with the insurance provider under which individual insurance provided to each member who applies for cover is tailored and underwritten. **The legislation does not allow commission to be paid on this policy.**

Recommendation 24

The FSC recommends that it is critical that the insurance exemption in s963B(1)(b)(i) for a group life policy for members of a superannuation entity does not capture master policies that permit insurance cover in choice funds taken up by members on a voluntary basis where that insurance is tailored to the needs of the individual member.

Section 963B(1)(b) should read as follows:

the benefit is given to the licensee or representative in relation to a life risk insurance product other than a life policy for a member of a default superannuation fund (see subsection (2)).

Section 963B(2) as drafted should be deleted

Section 963B(3) is amended to read as follows:

A life risk insurance product is a *life policy for a member of a default superannuation fund* if:

(a) **the product is issued to an RSE licensee of a registrable superannuation entity, or a custodian in relation to a registrable superannuation entity, for the benefit of a person or persons who are members of the entity that is a MySuper product; and**

(b) **MySuper product has the same meaning as in the Superannuation Industry (Supervision) Act 1993**

The FSC is not recommending commissions be permitted in respect of superannuation members who have default levels of cover and who do not seek or receive individual financial advice specific to their needs. In this situation, the FSC supports the Government's policy prohibiting commissions for default insurance, whether that insurance is provided through a group policy or an individual policy.

However, we submit that this objective can be achieved whilst ensuring consistent treatment for members of group master policies (that are provided tailored insurance solutions) and other superannuation fund members.

Recommendation 25

The FSC recommends the definition of "group life policy for members of a superannuation entity" in section 963B(2) could be expanded to include additional RSE provisions ensuring that non-MySuper RSE's must not default members into insurance arrangements where conflicted remuneration is payable.

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COMPARISON OF THE FEATURES OF INSURANCE IN SUPERANNUATION

GROUP OFFERING IN SUPERANNUATION		**INDIVIDUAL OFFERING IN SUPERANNUATION**
Default/MySuper	**Choice/Group**	
• Employer/adviser determine cover design • Member is defaulted/provided cover automatically • Members may opt-out at any time	• Adviser/member determine cover design (e.g. product types, sum insured) • Member actively chooses to take up cover • Member can cancel policy at any time	• Adviser/member determine cover design (e.g. product types, sum insured) • Member actively chooses to take up cover • Member can cancel policy at any time
FoFA Bill - commission cannot be paid	FoFA Bill - commission cannot be paid	FoFA Bill - commission can be paid
• Trustee is the owner of the policy • Administrative efficiency for super fund • Insurer covers the 'group of members' • Members can access group premium rates (i.e. lower than individual rates) • Super fund can Successor Fund Transfer (SFT) entire insurance offering • Super fund can update and improve insurance offering as appropriate without the need for members to change policy		• Trustee is the owner of the policy • Super fund administration is less efficient • Insurer only offers member individual premium rate (i.e. higher cost) • SFT limited because super fund cannot amend the individual insurance contracts • Members must 'switch' policy themselves

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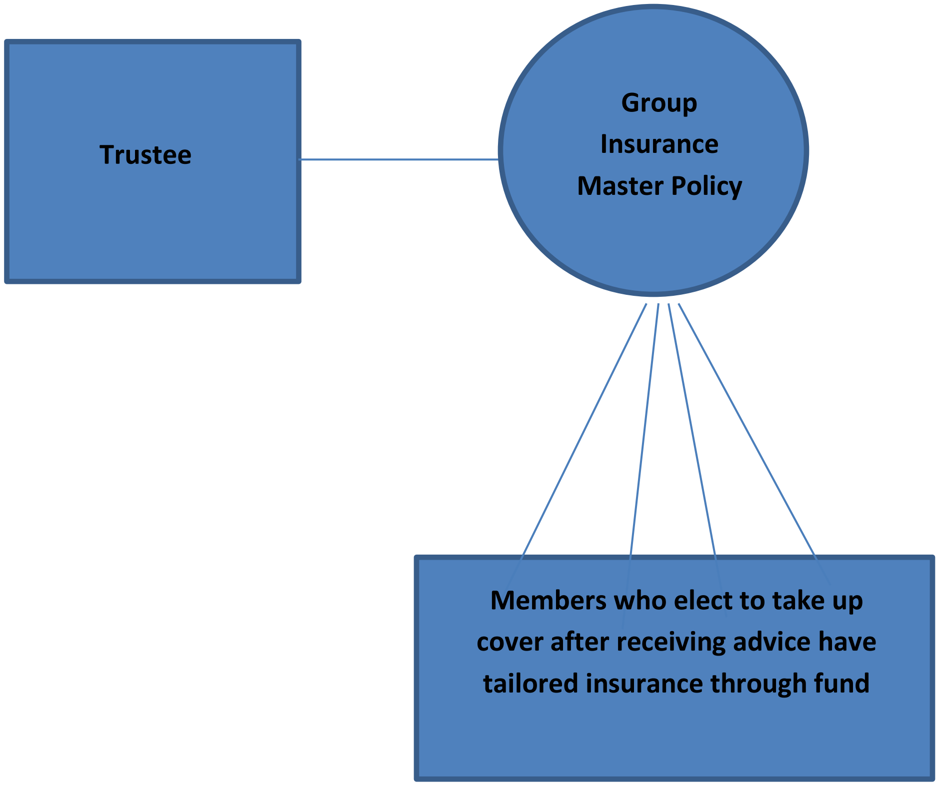
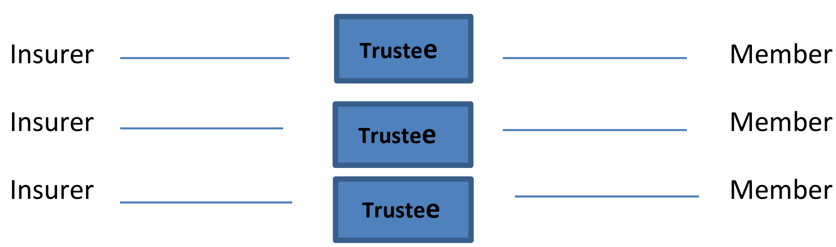
The following is a visual representation of the difference in structure of insurance policies available in superannuation through a group master policy and individual policies.

A. GROUP INSURANCE – master policy in the superannuation ‘choice’ environment



B. “INDIVIDUALY ADVISED” policies held in superannuation



5.3 Division 5 – Other banned remuneration

The Minister announced in April 2011[32] that "if structural reforms in the industry is to truly transpire, all conflicted remuneration, including volume rebates from platform providers to dealer groups must cease." Further the Minister was quite clear that "there will be a broad comprehensive ban, involving a prohibition of any form of payments relating to volume or sales targets from any financial services business to a dealer group, authorised representative or advisers".

We are broadly supportive of the policy intent of Division 5 as described in paragraph 2.50 of the EM. However, Division 5 is not limited to payments that are paid to a dealer group, authorised representative or advisers (as previously specified by the Minister).

Instead this section is a broad principles-based ban on the payment of any benefit which is determined by volume between any licensees and operators of custodial arrangements.

This Division has the potential to adversely impact the efficient operation of the funds management industry – potentially putting it out of step with international markets and impacting Australia's ability to compete as a financial services centre.

Further, contrary to our understanding of the policy intent, this Division appears to have a number of unintended consequences, including:

(a) The proposed ban captures platforms that do not seek to influence client decisions in relation to financial products accessible through the platform;

(b) The definition of "funds manager" captures many entities who are not funds managers;

(c) The term "volume-based shelf space fee" on which the entire division hinges on is broadly defined on a presumption of any benefit determined by value which captures many types of payments that are not shelf-space fees (as commonly understood);

(d) Dollar based fees – the legislation does not exclude "flat" shelf space fees that are operational in nature as announced by the Government in April 2010;

(e) Volume rebates paid by fund managers with respect to pooled investment vehicles appear to be banned for IDPS structures, whether or not they are 'reasonable', potentially creating a distortion in the market by giving a competitive advantage to mandate structures. As previously documented in numerous FSC submissions to Treasury, bias to one investment management structure will distort the market reducing market competition and directly resulting in increased investment costs for retail clients.

[32] Op Cit, page 9

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(f) To the extent that a rebate or discount is banned by this section, consumers of these investments will no longer be able to benefit from the Platforms passing on these rebates or discounts (through a credit to their investment or superannuation account).

The policy announcements had stated that only volume based shelf space fees paid by a fund manager to a platform provider (and any sharing of these with licensees and/or advisers) would be banned.

The provisions are much broader due to the definitions of "funds manager" and "platform operator" being simply referenced as licensee to licensee which captures many other licensee to licensee payments. The application of the provision means that it may apply in much broader circumstances than simply for fund managers to platform providers and does not just prohibit payments for shelf space.

5.3.1 Application of Division 5

Definition of "funds manager"

In effect, the elements of the definition of "funds manager" in section 9641(1) are sufficiently broad to capture any financial services licensee or RSE licensee including for example an insurer.

The definition would capture a licensee even if the licensee does not:

(a) Issue the product; or

(b) Manage the product.

The definition would capture a licensee even if the product is not:

(a) A managed fund; or

(b) Any other kind of investment product.

For example, the definition of "funds manager" would include a financial planner who is arranging for an insurance product to be issued to a client. The insurance product would be "the funds manager's financial product" because the planner is dealing in the product.

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Recommendation 26

We recommend that s964 should define the terms used in s964A as follows:

(a) **"funds manager" means the issuer or manager of an investment product available through a custodial arrangement, excluding an issuer or manager who is in the same wholly owned corporate group as the platform provider**

(b) **"funds manager's financial products" means financial products issued by the funds manager that are held by or through the custodial arrangement by or on behalf of retail clients .**

5.3.2 Definition of "volume-based shelf-space fee"

Because the definitions of "funds manager" and "platform operator" are too wide, the following payments seem to fall within the ban:

(a) A payment by a financial planner (the "funds manager") to a research house for information on products, where the payment is on a per-product basis;

(b) A payment by a product issuer to its own service provider who runs the issuer's own electronic applications process, if the payment is based on the number of products available or the number or value of products issued;

(c) A "return" benefit payment by a fund manager/bank to a superannuation trustee of the investment returns or interest on funds placed with the funds manager/bank for management (as these payments are benefits that are necessarily volume-based);

(d) A payment to an administration service by a financial planner who uses the service to keep track of the investments of the planner's clients;

(e) Payments between entities in the same wholly-owned corporate group, where several such entities are involved in providing the platform and underlying investments.

(f) The payment of insurance benefits by a life company to a superannuation trustee where the trustee has a group life policy or a life policy for a member of a default superannuation fund;

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Recommendation 27

The FSC recommends that shelf space fee be defined. The Definition should not be simply any benefit determined by value or number of financial products which effectively catches all benefits including genuine permissible payments.

Currently, the ban applies where any payment is received by the "platform operator" from a "fund manager". However, the ban should only apply where the platform operator passes the benefit through to the licensee/representative as that is the conflict the Government has explicitly sought to address. The policy position on this matter has always aimed to only prohibit volume based shelf space fees that are paid to or shared with advisers or their licensee.

Recommendation 28

The FSC notes that Division 4 effectively bans conflicted remuneration being paid by a product provider, like a platform operator and from being received by a adviser/licensee.

Therefore the FSC recommends that the prohibition in Division 5 section 964A should be amended so that it only applies to a platform provider paying or sharing a volume based shelf space fee with a licensee or representative who provides advice to retail clients.

As stated previously, section 964(1) of the legislation has the potential to catch general insurance and life risk insurance payments which fit the broad definition of a volume based shelf space fees. This ban is contrary to announced policy in the April 2011 announcement where the Government stated that the ban on volume payments "will not apply to pure risk insurance"[33].

Recommendation 29

The FSC recommends the definition applicable to s964A be expressly narrowed to a fund manager and platform/custodial arrangement.

Alternatively, the FSC recommends life risk and general insurance should be carved-out from the ban on volume based shelf space fees (similar to the carve-out for conflicted remuneration).

In addition, we have significant concerns with the workability of subsection 964A(3)(b) in terms of being able to determine whether or not a "benefit exceeds the reasonable value of scale efficiencies".

See section 5.3.5 for a detailed explanation of our concerns with this qualification.

[33] Op Cit , page 10.

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5.3.3 Dollar-based fees

While the intent of this section is not to capture fees that represent annual or one-off dollar based fees (not related to "volume") charged by the platform to the fund manager that are operational in nature[34], we believe the current drafting of this provision does not permit dollar based fees.

Subsection 964A(2) presumes all payments which are dependent on the total number or value of a fund manager's financial product are "volume based shelf space fees". In practice, the extent of these dollar-based, operational fees will be dependent on the total number of the fund manager's products that are issued through the facility. For example, the platform operator charges $5,000 per fund on the menu, so that if a fund manager has five funds on the menu (a total charge of $25,000). As a result, the payment made by the fund manager is still "dependent on the total number" of that manager's funds on the platform.

The effect of this drafting is that genuine "dollar-based" shelf spaces fees charged by platforms are caught by the ban. The legislation then places the onus of proof on a recipient to demonstrate that the fees are "a reasonable fee for service provided to the funds manager by the platform operator" section 963A(3)(a).

This onus of proof creates an unnecessary administrative/compliance burden and adds to the cost of operating a platform business – which includes superannuation funds. These added costs are ultimately borne by the consumers of these financial products/services.

Recommendation 30

The FSC recommends that the drafting of section 964A(2) be amended to ensure annual or one-off dollar based fees (not related to volume) charged by the platform to the fund manager, that are operational in nature, be expressly carved out from the definition of a volume-based shelf-space fees.

5.3.4 Rebates and pooled investment structures

The drafting of subsections 946A(3)(b) results in mandate structures (i.e. private wholesale investment relationships) being placed at a competitive advantage over pooled investment vehicles. Superannuation funds and platform providers often invest in managed investment schemes and other pooled arrangements which are offered via a PDS rather than mandates.

As outlined in previous submissions and in discussions with Treasury, institutional investors who invest via pooled investment vehicles (such as a superannuation fund) often receive volume rebates (a physical payment which reflects the size of any discount negotiated on the basis of

[34] The purpose of this payment is for the ongoing administration and management of the Fund Manager's products on the platform. This can include costs the platform operator incurs for reporting, distribution processing, Anti Money Laundering / Counter Terrorism Financing compliance and other activities platform conduct for the direct benefit of the fund managers. It is usually a standard access fee charged per fund.

the scale of the investment) which results in a level playing field with other product providers using mandate structures (where the discounted price is negotiated up-front and therefore reflected in the fees at the outset).

Our understanding of the intent of the legislation is that the ‘benefit’ inherent in both of these structures (a rebate in the case of the where the investment is via a pooled investment vehicle and a discount in the case of mandate structures) is intended to be described by both subsections 946B(1)(b) and 964B(2)(a). However, we do not believe these subsections adequately describe the rebate paid by fund managers to (product) licensees/RSE investing in pooled investment vehicles.

Pooled investment structures charge all investors the same management fee (deducted by the fund manager in the unit price). The rebate is then paid by the fund manager to the platform (and may then be credited to the end investor’s account in part or in full by the platform).

The reference in subsections 946A(3)(b) to a ‘rebate of an amount paid, to the funds manager by the platform operator’ is not reflective of how the payment flow operates where rebates are paid by the fund manager to platforms with respect to amounts invested into pooled investment vehicles.

As a consequence, we believe that the drafting of subsections 946A(3)(b) does not permit rebates of investment management administration fees for institutional investors like super RSEs and IDPS structures, whether or not they are ‘reasonable’, creating a distortion in the market by giving a competitive advantage to those who invest via mandate structures.

We suspect that this is a technical oversight; nevertheless it is critical to ensuring a level playing field and a world leading and fair and fully competitive funds management market.

Recommendation 31

The FSC recommends that section 964A(3)(b) be amended to permit rebates paid by the fund manager to a product provider (“platform operator”).

This amendment is congruent with Government policy and intent and enables the Australian funds management industry to continue to offer both mandate and pooled investment structures thus maintaining a competitive neutral system.

5.3.5 Retaining the benefits of scale for Australian investors

The FSC’s members have significant concerns with the workability of the test in subsection 964B(3)(b).

Section 964A states that:

(a) a platform operator must not accept any payment of a benefit which is a discount or rebate (s964A(1);

(b) that is determined by "value of the fund manager's financial product" (s964a(2));

(c) unless the platform operator can prove the benefit "does not exceed an amount that may reasonably be attributed to efficiencies gained by the funds manager because of the number or value of financial products obtained by a fund manager" (s964A(3)(b).

Discounts and rebates will differ across the funds management industry as each fund manager will have a different cost base and different investment styles (such as active management or passive/index management). Discounts and rebates will also differ across the full spectrum of asset classes (Australian and international) due to the differing costs of managing these assets and also potentially between local and international managers.

In practice, a recipient of these discounts and rebates (like a superannuation fund) is unlikely to be able to determine with any degree of certainty that a payment does not exceed an amount that may reasonably be attributed to efficiencies gained by the funds manager because of the number or value of financial products obtained by a fund manager..

The operation of this provision could potentially give rise to perverse and counterproductive outcomes – whereby superannuation funds and platforms are restrained from negotiating the largest possible discount from a fund manager for the benefit of retail clients.

This provision will therefore likely result in significant distortionary effects which are detrimental to consumers and interfere in the efficient operation of a highly competitive market.

Recommendation 32

The FSC recommends that section 963A(3)(b) be amended to delete reference to a "scale efficiency test".

Further, the section should be amended to permit both mandate discounts and rebates of investment management costs. The section can achieve this recommendation by reading as follows:

"S964A(3)(b) a discount on an amount payable by the platform operator, or a rebate of investment management fees of an amount paid by the funds manager to the platform operator."

The remainder of the section should be deleted.

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5.3.6 Retaining scale discounts for the benefit of Australian investors

To the extent that a rebate or discount is banned by this section, end investors will no longer be able to benefit from the platforms passing on these rebates or discounts (through a credit to their investment or superannuation account).

We submit that only positive outcomes arise from allowing continued payment of benefits that are passed on (in full) to the end investor. Indeed, ensuring that the end client benefits from any discounting is consistent with FoFA's underlying policy principles. Passing through competitive prices in this way is a fundamental component of a healthy marketplace.

Recommendation 33 **The FSC recommends that s964A be amended to explicitly exempt any benefit that is passed on in full to the end investor to be permissible and not banned under this section. (refer to 6.3.7 below).** **That is, any volume related benefit payment that flows from a fund manager via a product provider licensee such as a custodial arrangement, superannuation fund or managed investment scheme should be permitted if passed in full to the retail investor without having to prove the benefit met s963A(3)(b) scale efficiency test.**

5.3.7 Division 5 and Superannuation Industry (Supervision) Act

A. Ability for super fund/platforms to pass volume related payments (rebates) on to members by way of discounted administration fees

Under current law and commercial industry practices, members of a superannuation fund (Registered Superannuation Entities ("**RSE**") and Licensees who operate a platform) ("**super fund**") may receive the benefit of a scale discount of a fund manager's (investment) administration fees, passed onto them (the member) because of a licensee/adviser's use of the platform.

The discount of the super fund trustee's administration fee is given as a volume related payment to the licensee/adviser because:

1. The discount relates to scale – that is a group discount (the licensee/adviser's business represent scale discounting power and the adviser fulfils servicing functions including providing general advice in relation to the super fund); and
2. The adviser business model may pass on any payment given to them by a product provider to the client whose moneys generated the payment.

The first point above has recently been endorsed by Choice as a legitimate business practice which enables a licensee to negotiate a group discount or monetary benefit for their clients.

Choice is a promoter (of a scheme) of One Big Switch (licensee) who "uses the switching power of 40,000 plus consumers to source home loan and electricity offers with a group discount[35]"

Returning to super funds, once FoFA is enacted as trustees/platforms will be prohibited under section 963 from giving any monetary benefits including this type of volume based payment to licensees, the trustee/platform will no longer be in a position to legally pass this discount (often referred to as a rebate) on to the member. In order for members to be able to benefit from discounts in administration fees negotiated by relevant licensees, trustees will effectively need to reflect the discount in the administration fees to members. The level of fee will differ depending on the relevant licensee.

The FSC submits that, consistent with the primary objectives of FoFA, it is important that this fee reduction be able to continue to be passed on to members and request that any necessary changes be accommodated within superannuation law (Superannuation Industry (Supervision) Act 1993 ("**SIS**")) to enable this form of discounting to continue from a super fund (who are platform operators) to the member. In our view this measure is essential to facilitate market competition on the price of administration services in a manner which will enable fund members to benefit directly from any resulting discounting.

Such differential pricing for different fund members is somewhat similar to that which occurs in relation to members of a corporate master fund who have joined the fund as employees of different employers, where different administration charges apply to employee members of different employers. However, we consider that it is necessary for the SIS Act to be amended to accommodate differential administrative charges on the basis described. We recognise that constraints are proposed in relation to charges imposed for MySuper accounts, and that there may be a need to ensure such amendments do not produce unintended consequences for MySuper accounts. However, we consider that that should be able to be dealt with in a relatively straightforward manner, given that none of the arrangements with which we are concerned involve MySuper accounts.

In the absence of the capacity to charge differential administration fees to fund members who are advised by different advisory firms, the only means by which independent providers of superannuation trustee/administration services are likely to be able to compete is by means of establishing a separate superannuation fund for different advisory firms, a process which inevitably adds inefficiencies and runs counter to one of the key thrusts of the Cooper recommendations: scale and efficiency.

[35] One Big Switch's website http://onebigswitch.com.au/howitworks

Recommendation 34

The FSC recommends that SIS amendments are necessary to allow differential administration fees to be charged by superannuation fund trustees (who are platform operators) to different members. This will accommodate discounting to members on a volume basis for different dealerships/advisers who have advised those members.

B. Fees for service interaction

FoFA explicitly aims to carve out "fee for service" from the definition of conflicted monetary remuneration (section 963B(d)). A fee for service arrangement is one where a client pays the advice directly for the service provided. However, the manner in which the provision is drafted would not expressly permit the fee for service to be paid from a members investment or superannuation account for example.

> *"S963B(1)(d) Benefits given by* ***or at the direction or request*** *of the client*. On current drafting, it is not clear whether the requirement for the benefit to be "given by the client" is satisfied where the client directs or requests a product issuer to pay the fee out of the client's product (including for example their bank account). For example, where a client chooses to pay for superannuation advice out of the client's superannuation account, the payment comes from the trustee or administrator rather than the client directly and is typically characterised as an expense of the fund recoverable from the client's account. Therefore, the benefit is arguably given by the trustee rather than the client, even though the benefit is coming from client money and was directed by the client. We also note that such an exemption would also require amendments to the *Superannuation (Industry Supervision) Act* 1993. This is of critical importance to ensure fee-for-service payment models can continue in a superannuation context."

As the Government has not sought to prohibit such arrangements, the FSC has made the following recommendation to The Treasury noting that the exemption requires amendments in the Superannuation (Industry Supervision) Act 1993 generally (not limited to MySuper) to enable a retail client to pay their adviser a fee for service for related financial advice from their superannuation account.

To this effect we are pleased to note the following comment made in the Explanatory Memorandum accompanying the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 before Parliament today:

> "5.21 Later tranches of legislation will also define those fees for financial advice that can be deducted from member accounts. There will also be specific charging rules that, in certain circumstances, permit fees for financial advice to be charged differently to members."

Recommendation 35

The FSC recommends that SIS be amended to permit Trustees to pay benefits given by agreement, consent or authority of the client for advice fees.

See Section 6.5.2 for further information.

5.4 Intra-Fund Advice

A key element of the Government's FoFA announcements made in April 2010, was the consideration of the provision of "low cost simple advice (known as Intra-Fund Advice)".

The Government's commitment to low cost simple advice was warmly welcomed by the industry. The ability to provide simple advice (at a lower cost) would deliver significant benefits for Australian consumers namely in the form of increasing accessibility and affordability of advice.

Importantly, access to affordable and scaled or piece by piece advice[36] is increasingly preferred by Australians over more complex/holistic advice, which is legally required to be given by a financial advice licensee under section 945A of the Corporations Act.

Critically, the FSC has always advocated for a product and channel neutral approach to scaled advice. That is, scaled advice was never envisaged to be limited to superannuation. Additionally, scaled advice was always expected to be subject to FoFA requirements – namely the best interest duty, renewal and the conflicted remuneration provisions to name a few.

As a result, the FSC has previously submitted on numerous occasions to Treasury that the concept of Intra-Fund Advice – which includes personal financial advice provided by a superannuation product provider – should be extended beyond superannuation so that Australians that invest in savings, managed investments and insurance products can also be afforded this low cost type of advice.

Unfortunately, there has not been an adequate opportunity to consult on many of the critical aspects of Intra-Fund Advice, prior to the Government's decision being made public. While we acknowledge that the topic was raised by the FSC numerous times during the Peak Consultative Group ("PCG") meetings, it was not the subject of detailed discussion.

For example, there has not been any consideration by the PCG or any other consultative process of:

[36] ASIC report *Access to financial advice in Australia (REP224,* December 2010 paragraphs 53 and 62.

(a) Whether it needs to be defined as a discrete category of advice or subsumed within a general advice framework which facilitates scalable advice;

(b) Who will be allowed to provide it and what license conditions may attach;

(c) The application of FoFA obligations such as best interests, opt-in (including fee disclosure statements), penalty provisions, transparency of fee disclosure etc;

(d) The subject matter of intra-fund advice (discussed for the first time in July 2011 by the PCG).

(e) Whether it can/should extend beyond simply ‘general advice’;

(f) Whether all forms of intra-fund advice should be permitted to be paid for collectively across a superannuation fund membership or whether certain forms of intra-fund advice (such as more complex personal advice relating to the member) should be paid for by the recipient of the advice; and

(g) Whether any cap should be placed on the total cost of intra-fund advice to a super fund membership given it is cross-subsidised by all members irrespective of whether they access the advice.

Given these matters have not been the subject of consultation, it is disappointing to see elements of the Intra-Fund Advice regime have already been inserted into the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and accompanying Explanatory Memorandum (“MySuper EM”).

The MySuper legislation and EM state that super fund members can be charged for financial advice (general and personal advice), regardless of whether the retail consumer requested or received any advice, from their superannuation account.

The actual fee for the advice is not required to be separately disclosed to super fund members. Instead, the cost of the advice is hidden within the “***administration fee***” disclosed by the fund.

The payment of Intra-Fund Advice on a hidden basis – replicating product commissions which will be banned by the Future of Financial Advice reforms - directly contradicts the central objectives of the reforms including:

- Increased transparency of advice fees paid by consumers;
- Ensuring that consumers who do not access advice are not paying for advice;
- Banning conflicted remuneration including product commissions for advice; and
- Enhancing consumer trust in financial advice.

The payment of Intra-Fund Advice fees from superannuation member's super monies will also not be subject to the Future of Financial Advice reform "Opt-In" measure despite the Cooper panel's comments that it also apply to superannuation:

> "The Panel notes the Future of Financial Advice reform package requires that if an adviser is to provide an ongoing service, the adviser must send an annual renewal notice to the client. Although those reforms are intended to apply in relation to any financial services, including superannuation, the Panel is particularly of the view that an annual renewal regime would be necessary in MySuper[37]."
>
> "The Government has already accepted the recommendations of the independent Superannuation System Review (the Cooper Review) that intra-fund advice can be collectively charged by superannuation trustees to their members and not be subject to provisions such as opt-in."[38]

The Government announcement on 8 December 2011 will continue[39] to *only* permit superannuation funds to offer Intra-Fund Advice[40] which will be able to provide any general and personal advice limited to the member's beneficial interest in the superannuation fund (the sole purpose test) and:

> "there will be new restrictions on the types of advice that can be provided under intra fund advice rules. Specifically, the following are excluded:
>
> - Advice relating to whether the member should consolidate their existing superannuation accounts
> - Advice to switch the member away from the superannuation fund into another superannuation fund except to the extent the advice relates to moving the member from an accumulation product into a retirement product offered by the same registrable superannuation entity
> - Advice that contains recommendations in relation to financial products that the member holds outside of superannuation
> - Advice in relation to investment choice outside of the trustee-prescribed investment options"

[37] Cooper Review: Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, *Superannuation System Review Final Report, Part Two, Recommendation Package,* 2010, page 21.

[38] Minister Shorten MR164 "Improving Access to Simple Financial Advice", 8 December 2011.

[39] Intra-Fund Advice is today only permitted to be offered by superannuation funds under a Class Order exemption [CO09/210]. Under a Class Order exemption [CO09/210], trustees of regulated superannuation funds are currently permitted to provide personal financial product advice in respect of various matters relating to the superannuation fund, and are exempted from section 945A of the Corporations Act in doing so. (Other licensed advisors are required to comply with section 945A). Hence, superannuation trustees relying on the Class Order can provide personal financial product advice without determining the client's relevant personal circumstances ("knowing your client" requirement), or considering and investigating the subject matter of the personal advice ("knowing your product" requirement). The superannuation trustee is also exempted by the Class Order from the section 945A requirement to provide appropriate advice. FoFA Best Interest Duty obligations replace s945A of the Corporations Act. Class Order 09/210 has not been repealed by ASIC at the time of writing this submission.

[40] The MySuper Bill legislates the ability for a superannuation fund to charge a superannuation this this fee collectively.

This means MySuper members, deemed to be investors requiring the greatest levels of protections, will pay for financial advice, regardless of whether they access this general and personal financial advice.

We note that the MySuper legislation allows superannuation trustees to charge advise fees bundled with the administration cost of the fund - exactly the same 'conflicted remuneration' the FoFA reforms aim to stop.

Indeed, Industry Super Network (ISN) has been very outspoken about these very types of fees and costs. A sample of their comments on these matters follow:

> "these members are not informed (advice fees are not disclosed but bundled as administration cost) of the service they are paying for but not necessarily receiving[41]"

ISN asserts that payments (namely commissions) of the following nature are conflicted and has on numerous occasions recommended they be banned:

> "such fees are ongoing in nature and therefore not necessarily reflective of the advice received[42]"
>
> "cause a conflict of interest because the adviser is paid by the product provider not the client, and so will only be paid for recommending a certain product[43]"
>
> "are economically inefficient in the sense that they are not tied to the provision of quality of advice – commissions are paid irrespective of ongoing provision of advice services[44]"
>
> "commissions are often justified as being a cost effective way for consumers to pay for advice, particularly for lower income consumers. ISN has long challenged this view due to the ongoing nature of commissions and the fact that commissions are paid irrespective of whether ongoing advice is provided[45]"

A superannuation trustee (or advice licensees to whom a superannuation trustee outsources the advice function) will continue to provide conflicted advice because the advice provider can only advise the client with regards to one related party product. As ISN has previously stated:

> "Wherever a client is given advice, and that advice is skewed towards particular products due to related party interests….. their financial outcomes are very likely to be diminished"[46].

To be clear, the FSC welcomes the removal of legislative barriers that prohibit (directly or indirectly) the financial advice industry from providing piece-by-piece (or scaled) advice or for a superannuation fund or other product provider to offer simple advice.

[41] *Industry Super Network Submission* to the Parliamentary Joint Committee on Corporations and Financial Services, August 2009.

[42] Ob Cit, pg 18.
[43] Ibid, page 9.
[44] Ob Cit.
[45] Ibid, page 13.
[46] Ibid, page 12.

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However, the FSC believes the proposed framework supporting the provision of Intra-Fund Advice is entirely inconsistent with the policy rationale underpinning the FoFA and MySuper reforms.

The proposed framework permits an advice fee to be bundled with a product administration fee and to be charged to all members of a superannuation fund regardless of whether the member accesses any advice.

In our view, this framework is at odds with the Minister's second reading of Bill 2 in Parliament, where he said:

> "It is only by ensuring that advisers' only source of income is from their clients that clients can be sure that the adviser is working for *them,* rather than a product provider.
>
> For the most part, advisers will not be able to receive remuneration (from product issuers or from anyone else) which could reasonably be expected to influence financial advice provided to a retail client."

<u>Cost of intra-fund advice</u>

Proponents of Intra-Fund Advice often argue that it is relatively inexpensive, especially when assessed at a member, rather than whole of fund, level.

Indeed, ASFA's submission to this inquiry argues that given the costs are relatively low on a per member basis, the benefits of this form of advice merit its provision on a collective basis.

The FSC does not share this view. For the reasons outlined above, we believe a preferable approach would be to adhere to the principles underpinning the FoFA and MySuper reforms and facilitate scaled advice on a product and channel neutral basis.

Importantly, the FSC has always supported the provision of general advice (factual information) from a superannuation fund about a member's interest in that superannuation fund. Allowing this form of general advice to be provided, while at the same time developing a product and channel neutral scaled advice framework, would better achieve the policy objective of increasing the availability of simple and cost-effective advice without creating an uneven playing field and compromising the underlying principles behind these reforms.

The FSC has conservatively estimated that the provision of Intra-Fund Advice by all superannuation providers would result in approximately **$405 million** per annum being deducted from all superannuation fund member accounts.

Significantly, the Cooper Review found that 80% of members are disengaged. On this basis, it is reasonable to conclude that up to **$324 million** (80% of **$405 million)** is being paid by disengaged members who are not receiving any advice – but who are nevertheless cross-subsidising personal advice being received by the remaining 20% of fund members.

COST OF INTRA-FUND ADVICE

Methodology

1. Compulsory provision of Intra-Fund Advice ("**IFA**").

2. Cost of IFA: The Association of Superannuation Funds of Australia Limited ("ASFA") Submission to the Parliamentary Joint Committee, 25 November 2011, page 3 states that "expenditure on financial planning services varied from $0.65 a year per member to $26.25". Selecting the mid-point, approximately $13.50 per year is paid by members for IFA.

   An IFA cost of $13.50 per year equates to $0.26 per week, per account. FSC believes this is a conservative estimate on the basis that increasing amounts of personal advice will be provided in the future – driven by retention motives and an aging member base – resulting in higher overall IFA costs.

3. Account numbers: Approximately 30,000,000.

4. IFA is charged as part of the administration fee which is levied on every account (as opposed to a unique member).

Total cost to superannuation fund members is approximately $405 million per annum.

5.4.1 Interaction between FoFA and MySuper

Notwithstanding the previous comments, there are a number of other challenges posed by FoFA on the ability of superannuation fund trustees to offer Intra-Fund Advice under a bundled ongoing fee (i.e. administration fee) basis:

- Can a superannuation trustee, which is a financial services licensee who provides financial product advice able to receive Intra-Fund Advice fees given it is a benefit which could "reasonably be expected to influence the choice of financial product recommendation"(s963A)? There is no current exemption in the Bill which would permit the receipt of this benefit. The exemption in s963B(d) stipulates the benefit if given by the client which is not a passive requirement.

- Is a superannuation trustee able to 'give' a benefit (Intra-Fund Advice fee charged to members) to another (advice) licensee who provides financial product advice to a retail consumer?

- Is the related party (advice) licensee able to receive the benefit (for Intra-Fund Advice fees) from the superannuation fund for the provision of financial product advice to retail consumers?

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2. Will s963 permit a superannuation fund from charging the Intra-Fund Advice fee (as an administration fee which is a product fee contained in a general advice document) given the fee is given to a licensee for general or personal advice?

Recommendation 36

The FSC recommends that advice fee charging mechanisms apply consistently across FoFA/MySuper reform Bills before Parliament.

FSC Recommendation 9 in the MySuper Submission to the PJC states "that the fee definitions should omit personal Intra-Fund Advice as an element which can be cross-subsidised through the MySuper administration Fee"

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5.5 CONFLICTED REMUNERATION OTHER RECOMMENDATIONS

5.5.1 Section 963 Definition of Conflicted Monetary Benefits

The FSC submits the definition of conflicted benefits, both monetary and non-monetary, is too broad and goes significantly beyond the scope of the stated objectives of the FoFA reforms.

The Government stated in April 2010, that “distortions to remuneration, which misalign the best interests of the client and the adviser, should be **minimised**[47]”.

Application to general advice

Section 963A bans any monetary or non-monetary benefits given to the licensee providing general and personal advice, unless carved out by sections 963B and 963C.

General advice, by its very nature, can be cast widely. General advice is advice that does not take into account any personal circumstances of the client. General advice must be accompanied by a general advice warning to the effect that the advice does not consider the client’s personal circumstances and that therefore, the client should consider their personal circumstances and the Product Disclosure Statement (“PDS”) before making a decision.

It is important to note that the financial advice practices which were the subject of the PJC review in 2009, were not matters relating to general advice.

General advice is included in broadcasts and media advertising, newsletters, websites, seminars, product offer document/brochures like a PDS, call-centre operations and billboards. General advice may also include advice that is not product specific or which has an educational or informative purpose.

Accordingly, we submit that general advice is:

(a) Given in a far wider range of circumstances than personal advice and is therefore likely to apply to a far wider range of situations than is necessary or intended;

(b) Far less influential on the decision of a retail client than personal advice; and

(c) Not the context in which the issues and concerns referred to in the Explanatory Memorandum arise.

If the ban is intended to apply to general advice, we submit that exemptions are necessary to avoid unintended consequences, particularly given the low threshold test for determining whether a benefit is prohibited- that is whether the benefit “might influence” advice. For example, general advice in broadcasts and media advertising, newsletters, websites, seminars,

[47] The Future of Financial Advice Information Pack Monday 26 April 2010.page 2.

product brochures and billboards is cast widely without necessarily being linked to a product being issued. General advice that is available to the public at large should be excluded.

Recommendation 37

The FSC recommends that the giving of general advice, for example by providing material or information which is "generally available", should not be advice caught by the far reaching definition of conflicted remuneration.

5.5.2 Additional or expanded exemptions for both monetary and non-monetary benefits

We submit that the ban on conflicted remuneration should expressly not apply to:

(a) *Benefits that depend on or are calculated by reference to benefits or other factors that are not caught by the ban on conflicted remuneration.* This could arise because the underlying benefits are:

(i) not caught,

(ii) caught but exempt, or

(iii) caught but grandfathered.

for example, fee for service amounts paid by the client based on funds under advice are not caught by the prohibition (nor should it be). However, a bonus scheme paid by the licensee or employer that was based on the aggregate of such fee for service revenues generated by the adviser would be banned because it depends in part on funds under advice.

(b) *Exempt benefits*: any advice about general insurance, basic banking products and exempt life insurance, regardless of who is giving the advice or paying the benefit. Currently, advice remuneration on these products is only exempt when the advice or the benefit is provided by the product issuer. There is no policy reason why these exemptions should not extend to where a benefit is paid by someone other than the product issuer in respect of general insurance or the specified life insurance – particularly given that those advisers are likely to be less conflicted than the product issuers themselves.

(c) We note the ability of bank staff to be rewarded with exempt conflicted remuneration in respect of basic deposit products. We submit that any remuneration for financial services in respect of basic deposit products be exempt from conflicted remuneration, regardless of who provides those financial services.

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(d) *S963B(1)(d) Benefits given by agreement, consent or authority of a retail client.* On current drafting, it is not clear whether the requirement for the benefit to be "given by the client" is satisfied where the client directs or agrees, consents or gives authority to a product issuer to pay an advice fee out of the client's product (including for example their bank account). For example, where a client chooses to pay for superannuation advice out of the client's superannuation account, the payment is given to the advice by the trustee or administrator albeit on the client authority and is typically characterised as an expense of the fund recoverable from the client's account. Therefore, the benefit is arguably given by the trustee rather than the client, even though the benefit is coming from client money and was authorised by the client. We also note that such an exemption would also require amendments to the Superannuation (Industry Supervision) Act 1993. This is of critical importance to ensure fee-for-service payment models can continue in a superannuation context. The EM certainly intends these benefits to be permitted (para 2.26).

Recommendation 38

The FSC recommends that s963B(1)(d) be amended by adding "whether directly or indirectly" after the word "given".

Alternatively, the provision requires amendment to permit benefits *given by agreement, consent or authority* of the client to the adviser.

(e) *Benefits given by or at the direction or request of the client, regardless of why the benefit was paid.* On current drafting, the carve-out is confined to benefits relating to the issue of a product by the person receiving the benefit, or to advice provided by the person receiving the benefit. This means that the carve-out does not apply to other services such as arranging for the issue, acquisition, application, variation or disposal of a financial product, or for custody, or for credit assistance, or for providing factual information, or for budgeting advice.

Recommendation 39

The FSC recommends that the ban on conflicted remuneration not apply to benefits calculated by reference to benefits that are not caught by the ban. These benefits would be calculated by reference to:

(a) **benefits not caught by the ban on conflicted remuneration;**

(b) **benefits caught but specifically excluded from the ban on conflicted remuneration; and**

(c) **benefits that are grandfathered from arrangements existing prior to the introduction of the reforms.**

(f) Purchase of financial planner's business by the licensee. It is common for licensees of authorised representatives who provide financial planning services, to offer to purchase the business of a planner when that planner retires, becomes permanently disabled, leaves the financial planning industry (permanently) or dies. The licensee may then on sell that business in whole or in parts to other planners in its network. This is to ensure that clients continue to receive their ongoing financial services and the authorised representative is able to achieve a sale of their business, if such a sale has not been possible on the open market.

(g) While the sale of a business is the sale of an asset, that asset includes a register of clients and their product holdings. The valuation therefore has a connection with the number of products held by those clients. Such connection should be divorced from application of the definition of conflicted remuneration by way of a specific exemption. A financial planner should be able to sell their business to their licensee without that sale and any subsequent sale by that licensee, being considered conflicted remuneration simply because the nature of the business involves financial products.

Recommendation 40

The FSC recommend that the purchase and sale of financial planning businesses as between licensee and its authorised representatives be specifically exempt from 963B.

The execution only exception contained in s963B(1)(c) will not apply if the licensee or representative has previously provided advice to the client. There is no causal link and no time limitation as part of this clause. Because of this, it will not be administratively possible to ensure compliance with this provision.

For example:

(a) (*Marketing campaign*) A general marketing campaign in the past conducted by the licensee that contained general advice relating to superannuation products. This would mean that any authorised representative of the licensee will not be able to rely on this exemption for execution only services in relation to superannuation products.

(b) (*Previous advice*) An employed financial adviser may have provided advice in relation to managed investment schemes as part of a financial plan five years ago to the client. This will mean that any execution only services in relation to managed investment schemes provided by an adviser (of the same licensee) now will not fall within the execution only exemption.

Recommendation 41

The FSC recommends that the exemption in s963B(1)(c) should be amended to:

(a) **include a causal link between the advice provided now and the advice provided in the past; and**

(b) **require that it be for past advice given by the relevant representative (and not by any representative of the licensee).**

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5.5.3 Non-monetary benefits

Paragraph 2.39 of the Explanatory Memorandum ("**EM**") states that:

> *"The ban on non-monetary benefits is also not generally intended to cover the services provided by a licensee to its authorised representatives for the purposes of the authorised representative providing financial services on behalf of the licensee. These services would only be captured by the ban if the services were provided in such circumstances where it might conflict financial product advice."*

This statement confirms the intention of the Government to permit licensees to provide non-monetary benefits to authorised representatives for the purposes of those authorised representatives providing financial services. Some of the drafting for the exclusions to the overall ban on non-monetary benefits does not fully reflect the intention expressed in paragraph 2.39 of the EM.

Further, s963C as drafted captures benefits provided by an employer to their employee (Licensee to their representative). We believe this is unintentional and recommend these provisions be amended to include benefits from Licensee to an authorised representative and or their representative.

Recommendation 42

The FSC recommends that s963C explicitly carve out non-monetary benefits given by a licensee to their employee – that is authorised representative(s) and representative(s).

A. Dollar limit: s963C(b)

The FoFA legislation now places a ban on licensees (not limited to advice licensees given the definition of conflicted remuneration includes general financial product advice) from receiving non-monetary benefits. We appreciate the Government's intent is to increase consumer trust in financial advice prodviders and to raise the industry to a profession. We note that no other profession in Australian including the legal, medical nor accounting profession, nor other occupations of public trust like politician or journalists have a ban of this nature in place. The FSC jointly with the Financial Planning Association of Australia have to date retained a joint industry standard on this matter – such that non-monetary benefits over $300 received by a licensee and their employees were to be recorded on a register which is publically available.

Notwithstanding the above, it is our understanding based on discussions with Treasury in the Peak Consultation Group meeting held post the release of Bill 1's exposure draft, that the exception in s963C(b)(i) is intended to apply to the licensee and to each representative separately and not in aggregate. In other words, a benefit given to a licensee is only prohibited if the value of the benefit received by the licensee is $300 or more in value and a benefit given to a representative is only prohibited if the value of the benefit received by that representative is $300 or more in value. For example, a group of representatives could be taken out for lunch where the price per head was less than $300 each even if the total bill for the lunch is over $300. Therefore, there should be no aggregation of the value of similar benefits given to both a licensee and a representative or two or more representatives of the same licensee.

The same applies in relation to s963C(b)(ii), that is, no regard needs to be given to benefits received by the licensee or other representatives when determining whether or not a particular representative has received similar benefits frequently or regularly.

There is also considerable uncertainty about when a benefit is provided on a 'frequent or regular basis' under s963C(b)(ii). While we do not believe it is appropriate to define these terms in the legislation. We recommend that the EM should be amended to include examples of what is and is not deemed to be "frequent or regular" for clarity purposes.

For example, we would determine that taking a representative out to lunch once a year would not be "frequent or regular", but acknowledge other interpretations may exist and seek confirmation via an amendment to the EM that this example is not frequent or regular. Conversely, we acknowledge that taking a representative out to lunch once a month is likely to be interpreted as both frequent and regular.

Recommendation 43

The FSC recommends that the EM be amended to provide clarity regarding the application of the $300 limit – it not being an aggregate sum but per representative and to include examples of what is and is not deemed to be "frequent or regular" for certainty.

B. Conferences s963C(c)

We support the nature of the exemption provided in s963C(c) to allow the provision of genuine education or training. This is essential for licensees to meet their license obligations to have representatives appropriately trained and competent. Some relevant obligations in this respect are contained in the *Corporations Act* in s912A(ca); s912A(e); 912A(f); as well as license conditions. The training is also essential to keep abreast of industry developments both in Australia and to the extent we can learn from other jurisdictions, overseas.

We support the criteria suggested in the EM requiring minimum hours for education content and the expenses of attendance being paid for by the representative or their licensee. However, we believe that the only minimum requirement should be that the benefit has a genuine education or training purpose and that it complies with the regulations.

We do not believe that the relevance test in s963C(c)(ii) is needed in the legislation itself. If there are any concerns about particular types of training we submit that this could be addressed in the regulations.

Specifically, what is meant by the term “relevant to the provision of financial advice”? Financial advisers are engaged in a range of activities which extend beyond giving advice. Not only do they engage in dealing activities such as arranging for investments to be made and for trades to

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be placed, they also undertake administrative activities for clients. Furthermore, there is a range of training that may be relevant to the business of a financial adviser but which would not be obviously 'relevant to the provision of financial advice' such as training relating to equal opportunity, occupational health and safety training, running a (small) business and marketing. Nor would it permit the development of soft skills like client servicing/client relationship training which we understand from discussions from ASIC pre the issue of Consultation Paper 153, are areas ASIC is interested in seeing advisers improve. Courses on these types of topics are clearly for a genuine education or training purpose but could be prohibited by s963B(c)(ii). We are concerned that by requiring the training to be "*relevant to the provision of financial advice"* uncertainty may arise regarding the range of topics that can be covered at a conference.

Recommendation 44

The FSC recommends the deletion of s963C(c)(ii).

Alternatively, s963C(c)(ii) could be redrafted to read "the benefit is relevant to the provision of financial services or to the conduct of a financial services business;"

We submit that the criteria to determine whether professional development is genuine should not be defined by geography. The content should determine whether the activity is genuine. To limit the location to Australia or New Zealand would imply that conferences in other jurisdictions would not be genuine professional development. For example, the Financial Planning Association in the US has a regular conference and it is extremely beneficial for planners to attend. Great insights, the opportunity to learn from others and to understand industry trends can be obtained from attending such a conference. For Australia to be a financial services hub, it needs to effectively compete with other jurisdictions. To limit professional development to only Australia and New Zealand unnecessarily limits our opportunities as an industry.

Recommendation 45

The FSC recommends that the proposed professional development requirements be included in the regulations not be limited to Australia or New Zealand. The legitimacy of professional development or genuine education or training should be determined by the content rather than the location.

C. Australia's obligations under its various Free Trade Agreements

A further consideration is the possibility that the proposed legislation, if passed could be in breach of Australia's obligations under various free trade agreements, being a law limiting trade (travel and business dealings) to those destinations.

D. IT software and support: s963C(d)

The use of the expression "financial products issued or sold by the benefit provider" in sub-paragraph (d)(ii) unnecessarily limits the exemption to product issuers and does not include the licensee of a financial planner unless they also happen to issue products.

Licensees who provide financial planning often do not issue products or "sell" them. The most common scenario is for these licensees to be authorised to advise on, and arrange for a client to deal in financial products. We are also concerned for the reasons noted above that the benefit should not be limited to "the provision of financial product advice". The problem is even more acute in relation to this exception as any software or IT support is likely to relate to systems to facilitate advisers to access the issuer's product and to arrange for it to be issued to their client or to implement changes to product options. These activities are either dealing or administrative and are not in that sense "related to the provision of financial advice" which might be seen as limiting any software to research related information to enable an adviser to decide whether to recommend a product.

Advice licensees should be able to provide IT support and services to their authorised representatives and representatives and ensure issuers can provide IT support and services relating to arranging for products to be issued or varied.

Recommendation 46

The FSC recommends s963C(d)(ii) be amended to read "the benefit is related to the provision of financial services to persons as retail clients;"

E. Arms-length terms

To avoid any uncertainty, we submit that it would be useful for the legislation to contain a further exception for benefits provided to licensees and representatives on arms-length terms at fair market value.

Recommendation 47

The FSC recommends that amending the provision s963C(d) to the following effect would permit (carve-out) supply of legitimate goods or services on normal commercial terms to occur without infringing the ban.

(a) **provided pursuant to an obligation under a contract between the provider and the recipient, where the recipient has in effect paid for it; or**

(b) **payment for a service which the recipient has been contracted to provide, other than a service relating to sale of financial product.**

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CHAPTER 6: OTHER FOFA REFORMS

The FSC notes that there are a number of other key elements of the FoFA reforms outstanding which may have significant impacts on the operations of measures contained within Bill 1 and Bill 2. These include:

1. **Review of the defintion of retail/wholesale client**: as a significant number of measures contained within Bill 1 and Bill 2 hinge in application on the definition of a “retail client”, amendments to this defition may have significant impacts on the industry, in particular, the ability for the industry to comply with legislation by 1/7/2012. The industry is awaiting a policy position/outcomes following the consultation paper issued by Treasury (submissions closed 25 February 2011).

2. **Removal of the Accountants Exemption:** This reform will see significant changes to how accountants provide financial advice. A singificant number of the FSC’s members will be impacted by these measures. No announcements have been made on the framework/regime under which an accounting professional will be able to operate in a post FoFA environment. The industry is awaiting the Government to announce its position.

3. **Advisory Panel on Standards and Ethics for Financial Advisers.** This panel’s recommendations and subsequent Government announcements will have significant impacts to what training and competency advisers are required to have to comply with licensing obligations. These changes may not only result in significant re-training and enhancements for future competency testing of all 16,000[48] but may also impact new entrants (like the accountants). (Re)training of this magnitude requires time not unlike when FSR was introduced. Further as the Best Interest Duty hinges on competency of a reasonably experienced adviser, changes made to adviser competency requirements will consequently impact an adviser’s ability to comply with the Best Interest Duty. We note that the FSC was not a participant on this panel.

4. **Revision of the Financial Services Guide (“FSG”).** Announced in April 2010 as part of the FoFA reforms, consultation in ernest commenced on the FSG in late 2011. The disclosure document is still in consultation. We note that the industry requires on average 3-6months to amend critical disclosure documents.

5. **Statutory Compensation Scheme**. The Government engaged Richard St John, to advise Minister Shorten on the need for, and costs and benefits of, a statutory compensation scheme for financial services. The outcomes of this review are not yet public.

[48] Estimated number of advisers in the Australian financial advice industry.