

# Chapter 1

## Introduction

### Referral

1.1 On 20 March 2014, pursuant to the Selection of Bills Committee's report, the Senate referred the provisions of the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 (the bill) to the Finance and Public Administration Legislation Committee for inquiry and report.<sup>1</sup> Later that day, the Senate varied this order to provide that the provisions of bill be referred to the Economics Legislation Committee for inquiry and report by 16 June 2014.<sup>2</sup>

1.2 The main reason for supporting the referral of this legislation to a parliamentary committee was to 'provide a forensic and detailed examination' of the legislation and the effects this and previous reforms would and have had on the financial services and investment decisions.<sup>3</sup>

### Conduct of the inquiry

1.3 The committee advertised the inquiry on its website and wrote to relevant stakeholders and other interested parties inviting submissions. The committee received 36 submissions, which are listed at Appendix 1.

1.4 The committee held a public hearing in Canberra on 22 May 2014. The names of the witnesses that gave evidence are at Appendix 2.

### Background to the bill

1.5 In April 2010, the former government announced a package of reforms called the Future of Financial Advice (FOFA). On 13 October 2011, the Corporations Amendment (Future of Financial Advice) Bill 2011 was introduced into the House of Representatives. On that day, the House of Representatives referred the bill to the Parliamentary Joint Committee for Corporations and Financial Services (PJC) for inquiry and report. Six weeks later, on 24 November 2011, the Australian Government introduced the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. This bill was also referred to the PJC for inquiry and report. Both bills were referred to the Senate Economics Legislation Committee (the committee) for inquiry and report by 14 March 2012.

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1 Selection of Bills Committee, *Report No. 3 of 2014*, 20 March 2014.

2 *Journals of the Senate*, 20 March 2014, p. 685.

3 Appendix 2, Selection of Bills Committee, *Report No. 3 of 2014*, 20 March 2014.

1.6 The two bills represented the government's response to the PJC's 2009 inquiry into financial products and services in Australia that considered issues associated with corporate collapses, including Storm Financial and Opes Prime.<sup>4</sup> They proposed to amend the *Corporations Act 2001* (Corporations Act) to change the way the financial advice industry in Australia was regulated.

1.7 Together, the two bills were to implement the government's Future of Financial Advice (FOFA) reforms. Their focus was on developing a framework for the provision of financial advice in Australia with the underlying objective:

...to improve the quality of financial advice while building trust and confidence in the financial advice industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest.<sup>5</sup>

1.8 The reforms were also intended to facilitate access to financial advice through the provision of simple or limited advice. In particular, the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 set up a framework which included the following features:

- a best interests obligation for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients—the best interests obligation;
- a ban on conflicted remuneration, including product commissions, where licensees or their representatives provided financial product advice to retail customers; and
- a requirement for ongoing advice fees to be actively renewed by retail clients every two years.<sup>6</sup>

1.9 The PJC delivered its report on both the FOFA bills in February 2012, which included a dissenting report from coalition members that put forward 16 recommendations for changes to FOFA. At that time, the Coalition referred back to the findings and recommendations of the PJC's 2009 report, which it had supported, and in its view:

...provided a blueprint the government could have adopted with bipartisan support, to make important improvements to our financial services

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4 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

5 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

6 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

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regulatory framework to further enhance Australia's already first class regulation of the financial services industry.<sup>7</sup>

1.10 The Coalition was concerned that the PJC's 'very sensible and widely supported recommendations' had been jettisoned and that the FOFA legislation was 'too complex, costly to implement and created unnecessary red tape'.<sup>8</sup> It found the FOFA package of legislation as drafted 'unnecessarily complex and in large parts unclear' and, according to conservative industry estimates, 'likely to cost \$700 million to implement and a further \$350 million per annum for compliance'. Coalition members concluded that the legislation would lead to 'increased costs and reduced choice for Australians seeking financial advice'.<sup>9</sup> They could not support the proposed legislation.

1.11 Clearly, the reforms proposed by FOFA underwent extensive consultation, close scrutiny and generated considerable debate in parliament. The bills passed both houses with amendments, received royal assent on 27 June 2012 and the FOFA amendments commenced, on an optional basis, from 1 July 2012, and became compulsory from 1 July 2013.<sup>10</sup>

1.12 In July 2013, a few months before a general election, the Coalition, then in opposition, announced that after consulting widely for 18 months, it had developed a plan of action that would reduce the regulatory burden. Although it agreed with the policy intent of FOFA, in its view FOFA's 'unnecessarily heavy compliance burden' was 'strangling Australia's economic prosperity and development'.<sup>11</sup> The Coalition's intention was to have legislation accurately reflect the recommendations of the PJC's 2009 report.

1.13 Part of this plan involved amending the FOFA legislation to reduce compliance costs for small business, financial advisers and consumers who accessed financial advice. The plan cited the Financial Services Council, which estimated that the FOFA package would cost an estimated \$700 million to implement and impose a \$375 million compliance burden on the financial services industry each year. The Coalition stated that it would implement all 16 of its recommendations outlined in its 2012 dissenting report in an endeavour to reduce compliance costs.<sup>12</sup>

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7 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 152.

8 Explanatory Memorandum, Outline, p. 3.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, pp 152–153.

10 Explanatory Memorandum, Outline, p. 3.

11 Explanatory Memorandum, Outline, p. 3.

12 *The Coalition's Policy to Boost Productivity and Reduce Regulation*, p. 26.

1.14 After the election, and consistent with its stated intention, the new Coalition government proceeded to implement its action plan. On 20 December 2013, the then Assistant Treasurer, Senator the Hon Arthur Sinodinos AO, announced amendments to improve FOFA. The key elements of the government's proposed amendments included:

- the complete removal of opt-in—so that clients no longer needed to complete unnecessary paperwork in order to continue their arrangement with their adviser;
- the simplification and streamlining of the additional annual fee disclosure requirements—remove the retrospective application of the fee disclosure requirement so that advisers would not need to provide fee disclosure statements to clients who entered into a fee arrangement before 1 July 2013;
- improve the best interests duty—remove the 'catch-all' from the best interests duty to ensure that advisers could be confident that they had provided compliant advice to their client;
- provide certainty around the provision and availability of scaled advice—amend the best interests duty to explicitly allow for the provision of scaled advice that would enable advisers to agree with their clients on the scope of advice to be provided whilst ensuring that the advice was still appropriate for the client; and
- exempt general advice from conflicted remuneration—ensure that the ban on conflicted remuneration only applied to personal financial advice.<sup>13</sup>

1.15 The government released draft regulations and legislation on its announced reforms to FOFA for public consultation on 29 January 2014.<sup>14</sup> Fifty-seven written submissions were received and various consultation meetings held.<sup>15</sup> When releasing the draft legislation, Senator Sinodinos explained:

The Government is supportive of the principles of FOFA, but the previous Government's reforms are unwieldy, burdensome and unnecessarily complex. The proposed reforms will reduce the burden on industry and pressures on the cost of advice to consumers.<sup>16</sup>

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13 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, Delivering affordable and accessible financial advice' <http://axs.ministers.treasury.gov.au/media-release/011-2013/> (accessed 24 April 2014).

14 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, Delivering affordable and accessible financial advice' <http://axs.ministers.treasury.gov.au/media-release/011-2013/> (accessed 24 April 2014).

15 Explanatory Memorandum, Outline, p. 5.

16 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, 'Future of financial advice (FOFA) amendments released for public consultation', 29 January 2014, <http://axs.ministers.treasury.gov.au/media-release/002-2014/> (accessed 24 April 2014).

1.16 The consultation period lasted for three weeks, with submissions closing on 19 February 2014. The Assistant Treasurer anticipated that the bill would be introduced into Parliament in the 2014 autumn sittings with passage scheduled for the winter sitting period.<sup>17</sup> It should be noted that, in response to the feedback received during this consultation period, the government made further adjustments to the exposure draft particularly in the area of the carve-out for conflicted remuneration. The government has narrowed the broad exemption from this ban on conflicted remuneration to more specific areas of general advice.

1.17 In accordance with this schedule, the government introduced the bill into the House of Representatives on 19 March 2014. At that time, the Parliamentary Secretary to the Treasurer reinforced the government's message that the package of amendments contained in the bill would 'significantly reduce regulatory costs and provide greater certainty to industry in relation to their legal obligations'.<sup>18</sup>

### **Purpose of the bill**

1.18 The bill is intended to implement the government's election commitment to reduce compliance costs imposed on the financial services industry by amending Part 7.7 of the *Corporations Act 2001* (the Act). The bill includes the following key amendments to FOFA:

- removes the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement);
- makes the requirement for advisers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013;
- removes paragraph 961B(2)(g), the 'catch-all' provision, from the list of steps an advice provider may take in order to satisfy the best interests obligation;
- better facilitates the provision of scaled advice; and
- provides a targeted exemption for general advice from the ban on conflicted remuneration in certain circumstances.<sup>19</sup>

### **Structure of this report**

1.19 To provide the context for the examination of the provisions of the bill, the committee first provides an overview of the objectives of the FOFA reforms. In separate chapters, the committee then considers the following key amendments contained in the bill:

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17 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, 'Future of financial advice (FOFA) amendments released for public consultation, 29 January 2014, <http://axs.ministers.treasury.gov.au/media-release/002-2014/> (accessed 24 April 2014).

18 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, *House of Representatives Hansard*, 19 March 2014, p. 2371.

19 Explanatory Memorandum, p. 4.

- the best interests duty;
- scaled advice and the best interests obligations;
- modified best interests obligations;
- conflicted remunerations and exemptions; and
- opt-in provisions and fee disclosure statements.

### **Acknowledgements**

1.20 The committee thanks all those who participated in, and assisted the committee with, the inquiry.