

# Chapter 6

## Conflicted remuneration

6.1 Since 1 July 2012, under Division 4 of Part 7.7A of the Corporations Act, there has been a ban on conflicted remuneration.<sup>1</sup> Currently, remuneration received in relation to the provision of both personal advice and general advice is captured by the ban on conflicted remuneration. This arrangement reflects the fact that, while it is not in the nature of general advice for the provider to take the kinds of steps envisaged by the best interests duty, the provision of general advice may still be susceptible to influence by conflicted remuneration.<sup>2</sup> Currently, the legislation allows a targeted exemption for general advice from the ban on conflicted remuneration in certain circumstances.

6.2 In this chapter, the committee looks first at personal advice, general advice and commissions and then at the proposed exemptions from the ban on conflicted remuneration.

### Conflicted remuneration

6.3 Section 963A provides the following definition of conflicted remuneration:

Conflicted remuneration means any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:

- (a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or
- (b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

6.4 The original FOFA legislation recognised that a broad range of benefits 'could be interpreted as possibly influencing advice'. It also appreciated that benefits that would only have a remote influence on advice should not be caught.<sup>3</sup> Thus, the ban on conflicted remuneration does not apply to some areas.<sup>4</sup>

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1 *Submission 1*, p. [3].

2 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.12.

3 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.14.

4 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.8 and Explanatory Memorandum paragraph 3.6.

6.5 Sections 963B and C stipulate the circumstances under which a monetary or non-monetary benefit received by a financial service licensee, or a representative of a financial services licensee, is not conflicted remuneration. As it stands, the Act now imposes a ban on the licensee and their representatives from receiving remuneration that 'could reasonably be expected to influence the financial product advice given to retail clients'. The Act also bans the payment of such remuneration by product issuers or sellers.<sup>5</sup>

6.6 The current bill would amend the Corporations Act to broaden and clarify exemptions from the ban on conflicted remuneration. Specifically, the amendments relate to:

- general advice—providing a targeted general advice exemption from the ban on conflicted remuneration (section 963B);
- execution-only exemption—broadening the execution-only exemption so that it applies where no advice on that product, or the class of products of which the product is one, has been provided to the client by the individual performing the execution service in the previous 12 months (paragraph 963B(1)(c));
- education and training exemption—expanding the education and training exemption to include training relevant to a financial services business (paragraph 963C(c));
- basic banking—broadening the basic banking exemption so that it can be accessed when advice on other simple (Tier 2) financial products is provided at the same time as advice on a basic banking product and/or a general insurance product (section 963D);
- volume-based shelf-space fees—clearly defining volume-based shelf-space fees and the payments the ban on volume-based shelf-space fees intends to capture (subsections 964 (1) and (2) and section 964A);
- client-pays exemption—clarify the operation of the client-pays exemption (note at end of section 963A and 963B(1));
- mixed benefits—clarify the exemptions from the ban on conflicted remuneration to allow a benefit to relate to more than one exemption—that is permitting 'mixing' of benefits in relation to products or circumstances that are exempt from the ban on conflicted remuneration';<sup>6</sup> and
- regulation-making powers—introducing limited regulation-making powers to address future remuneration structures that may be inadvertently captured by the ban on conflicted remuneration.<sup>7</sup>

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5 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.7.

6 Explanatory Memorandum, paragraph 3.16.

7 Explanatory Memorandum, paragraph 3.20.

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## General advice exemption

6.7 Submitters did not comment specifically on all of the amendments providing an exemption from conflicted remuneration. They did, however, focus particularly on the general advice carve-out.

6.8 As the law now stands, remuneration (both monetary and non-monetary) received in relation to the provision of both personal advice and general advice is captured by the ban on conflicted remuneration. Nonetheless, the legislation allows for exemptions from this ban. Even so, in the government's view the application of the ban on conflicted remuneration imposed 'unnecessary burdens on industry by capturing individuals not directly involved in providing advice to clients'. For example, the Explanatory Memorandum noted that the ban currently:

...captures employees such as website designers or general information seminar providers who are not in product sales related areas. Industry argue that they are currently required to maintain complex systems when providing general advice to ensure compliance with the existing conflicted remuneration provisions. These systems are costly to implement and maintain.<sup>8</sup>

6.9 In response to consumer and stakeholder concerns about the original amendment being too broad, the government decided to restrict the operation of the carve-out.<sup>9</sup> According to the Explanatory Memorandum, the government has undertaken to provide a 'general advice exemption' from the ban on conflicted remuneration. The proposed exemption would only be available in particular circumstances.<sup>10</sup>

6.10 Although the bill would exempt general advice from conflicted remuneration under certain circumstances, conflicted remuneration on personal advice would continue to be banned.<sup>11</sup> The Explanatory Memorandum noted that the revised general advice exemption would exempt benefits from the definition of conflicted remuneration if the following conditions were satisfied:

- general advice is provided by an employee;
- the employee has not given personal advice to the person receiving the general advice in the past 12 months; and
- general advice is in relation to a product issued or sold by the employer.

6.11 The Explanatory Memorandum noted further:

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8 Explanatory Memorandum, paragraph 5.137.

9 Explanatory Memorandum, paragraph 5.147.

10 Explanatory Memorandum, paragraph 3.4–3.5.

11 Explanatory Memorandum, paragraph 5.135.

This amendment alleviates the unintended consequences of the original general advice ban without providing too broad an exemption. Website designers, people giving seminars, and other employees who are involved in the preparation of general advice, but who do not provide personal advice, will now be able to utilise the general advice exemption. However, advisers who provide personal advice as well as general advice will not be able to utilise the exemption. As such, this amendment removes the unintended consequences whilst still allowing consumers who receive personal advice to remain confident that their advice is in no way influenced by conflicted remuneration.<sup>12</sup>

6.12 The proposed amendments make a clear distinction between general and personal advice.

### ***Personal and general advice***

6.13 Personal advice is financial product advice that takes into account the client's objectives, financial situation and needs. ASIC provides the following guidance:

Advice may be regarded as personal advice if it is presented in a way that means a reasonable person might expect you to have considered one or more of the client's objectives, financial situation or needs.<sup>13</sup>

6.14 According to ASIC, the test for whether a provider is giving personal advice includes:

- whether the provider is in fact giving financial product advice—that is, whether the provider is making a recommendation about a financial product; and
- whether the provider has considered the client's relevant circumstances in relation to giving or directing the advice, or whether a reasonable person might have expected the provider to do so (section 766B(3)).<sup>14</sup>

6.15 On the other hand, general advice is financial product advice that does not take into account the client's objectives, financial situation and needs. ASIC makes the following distinction:

General advice about a financial product will not be personal advice if you clarify with the client at the outset that you are giving general advice, and you do not, in fact, take into account the client's objectives, financial situation or needs.<sup>15</sup>

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12 Explanatory Memorandum, paragraph 5.149.

13 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.43.

14 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.35

15 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.43.

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## Commissions

6.16 Many submitters spoke about the potential for a return of commissions. Indeed, some feared that the exemptions from the ban on conflicted remuneration would re-allow or reopen the door for conflicted forms of remuneration to be paid.<sup>16</sup>

6.17 The Explanatory Memorandum to the original FOFA described a commission as typically 'an arrangement between a product provider and the adviser or the adviser's licensee and is built into a financial product'.<sup>17</sup> FOFA recognised that product commissions:

...may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.<sup>18</sup>

6.18 As such, FOFA imposed a ban on the receipt of remuneration that could reasonably be expected to influence the financial product advice given to retail clients. There were a limited number of exemptions to the conflicted remuneration provisions and the bill seeks to broaden this carve-out further.

## Opposition to broadening exemptions from the ban on conflicted remuneration

6.19 As noted above, a number of submitters saw the proposed amendments as a way of reintroducing the payment of commissions on financial products and wanted no change to the bans on conflicted remuneration. One particular concern was exempting general advice from the ban on conflicted remuneration.

6.20 CPA Australia and the Institute of Chartered Accountants Australia were troubled by the prospect of a return to commissions—a specific payment in return for a specific sale, usually directly from a third party. They were strongly of the view that 'all commissions have the potential for real and perceived conflicts of interest and should therefore be removed'. In their view the proposal:

...to loosen this ban and permit commissions on general advice not only undermines the principles of the FoFA reforms, they return to encouraging a sales culture in the industry rather than focusing on provision of quality personal advice...Therefore it is imperative that conflicted remuneration structures, especially those usually aligned with sales, are removed.

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16 See Ms Campo, *Proof Committee Hansard*, 22 May 2014, p. 57 and Ms Storniolo, *Proof Committee Hansard*, 22 May 2014, p. 87.

17 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraph 3.24.

18 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraphs 2.3 and 3.27.

Despite the fact that general advice does not take into consideration a client's circumstances, the intention remains to influence the sale of a product otherwise there would be little value in remunerating general advice via a conflicted remuneration model.

Further, we are concerned returning to a conflicted remuneration model for general advice may adversely impact the community's perception of the broader financial services industry including those licensed advisers who provide personal advice. Given the very public debate over these reforms, and the number of consumer advocates engaged, this is a very real concern.<sup>19</sup>

6.21 They did not believe that the proposed changes were in the public interest. In their view, the low levels of financial literacy in Australia must be considered, as this factor 'substantially increases the risk that consumers may not be able to differentiate appropriately between general and personal advice'. In their minds, placing this onus on the consumer adds further complexity and uncertainty on those consumers who choose to seek advice.<sup>20</sup> In essence, CPA Australia was of the view that the trouble with commissions was their potential 'to create real and perceived conflicts of interest'. Mr Drum, CPA, and his colleague, Mr Elvy, Institute of Chartered Accountants, argued that remuneration models based on a commission structure do not align with the services generally provided by a professional.<sup>21</sup>

6.22 The Institute of Chartered Accountants would like to see more detail on this matter but would be comfortable with 'a form of incentivisation' if there were a balanced scorecard'.

6.23 To the suggestion that the government's intention was not to bring back commissions, Mr Elvy replied that:

One of the challenges, looking at the coverage of this reform debate, is: how does a consumer understand the concepts of general advice, personal advice, commissions and so on? There is still a lot of complexity there which we believe needs to be addressed. The concept of commissions with general advice we believe is probably confusing for consumers to understand.<sup>22</sup>

6.24 The concern about the return of commissions was shared by a number of other submitters. National Seniors argued that advisers must be free of any real or perceived bias at all times regardless of what type of advice they were providing to clients.<sup>23</sup> It then spoke of the risks that commissions pose to consumers:

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19 *Submission 14*, p. 6.

20 *Submission 14*, p. 6.

21 *Proof Committee Hansard*, 22 May 2014, pp 29 and 31.

22 *Proof Committee Hansard*, 22 May 2014, p. 32.

23 *Submission 24*, p. 3.

Commissions by their nature have the ability to influence advisers and create a conflict between advisers providing the most appropriate advice to the client and securing personal financial incentives from commission payments. At their worst, inappropriate arrangements for commissions can lead to the collapses of large companies and result in consumers losing millions of dollars in savings. ASIC indicates that conflicts of interest embedded in financial advice distribution and remuneration, that lead to poor advice, are the heart of this problem.<sup>24</sup>

6.25 It also noted that a larger number of consumers receive general advice as opposed to personal financial advice:

More and more consumers will receive their investment product information from general rather than personal advice, including advice received directly from the product issuers (which may be provided directly from bank and credit union tellers) bypassing the traditional personal advice provided by financial advice providers.<sup>25</sup>

6.26 National Seniors believed that providing a general exemption on the ban on conflicted remuneration would result in reduced quality of advice provided to consumers, leading to major consumer detriment.<sup>26</sup> It argued that 'consumers and the wider financial market must be protected from the detrimental impact of commissions on all levels of advice'.<sup>27</sup>

6.27 The FPA opposed strongly any possible reintroduction of commissions for financial product advice on superannuation or investment products. It acknowledged that there had been unintended consequences of the FOFA reforms for general advice providers. In its view:

...on a broad interpretation of section 963A and the term 'conflicted remuneration', the ordinary remuneration for general advice providers could be considered conflicted remuneration, even where that advice is limited to basic information about a product.<sup>28</sup>

6.28 The FPA explained that there were several risks associated with commissions for general advice, which included:

- the conflicted remuneration, which drives business models that encourage a complementary sales model of financial product issuance and distribution, poses a real risk of product mis-selling to retail investors and was rightly banned by the future of financial advice reforms;

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24 *Submission 24*, p. 8.

25 *Submission 24*, p. 8.

26 *Submission 24*, p. 8.

27 *Submission 24*, p. 8.

28 *Submission 15*, p. 7.

- commissions incentivise the provision of general advice as a form of consumer education or a replacement for personal advice—general advice is inappropriate for that purpose as it makes it more difficult for consumers to distinguish personal financial advice from marketing material or product sales;
- commission payments have eroded public confidence in our financial system—Australians will not have the confidence in our financial system as long as providers of products or advice are exposed to perverse incentives such as commissions; and
- allowing superannuation investment commissions to be paid on general advice has the potential to shift licensees and representatives away from the provision of personal advice in order to earn commissions.<sup>29</sup>

6.29 Mr Dante De Gori, FPA, sought to clarify his association's approach to remuneration, stating that it would object not only to commissions but to individual incentivisation on a per-product basis.<sup>30</sup> He then went on to explain that they wanted to remove anything that was directly embedded in a product:

Anything embedded in that product sale that is directly passed on to an individual is therefore a commission.<sup>31</sup>

6.30 Indeed, the FPA had 'no issue with the balanced scorecard approach with incentivisation, normal commercial arrangements that are reasonable in an employee situation—the issue was about embedded product commissions'.<sup>32</sup>

6.31 Mr Rantall, FPA, had concerns about the word 'advice' being used and attached to 'general' advice. Notwithstanding that objection, he was of the view that:

...if it is general information, people should be getting as much general information as they possibly can, whether it be from their bank or their superannuation fund. We have no issue with that. The issue we have is embedding commissions into product as a form of incentive payment. We also have no issue with reasonable balanced-scorecard-type salary and bonus payments.<sup>33</sup>

6.32 According to Mr Rantall it was:

unfathomable to think that someone could give general advice—not personal advice but one-off transactional advice that should not be specific to someone's circumstances—and potentially that person could receive an ongoing trailing commission for the rest of the life of that product, where

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29 *Submission 15*, p. 6.

30 *Proof Committee Hansard*, 22 May 2014, p. 21.

31 *Proof Committee Hansard*, 22 May 2014, p. 22.

32 Mr Mark Rantall, *Proof Committee Hansard*, 22 May 2014, p. 22.

33 *Proof Committee Hansard*, 22 May 2014, p. 21.



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the client has no control over that commission and cannot turn it off. It is a structural problem.<sup>34</sup>

6.33 Mr Rantall understood that that was not the intention of the proposed legislation. Even so, he stated, we 'still do not think it is the intent of the legislation, but it is the intent of the drafting'.<sup>35</sup>

6.34 In essence, according to Mr Rantall, the real issue was the 'separation of product from advice'. He argued:

If a commission is a conflicted remuneration then it is conflicted regardless of the business model in which it is paid or the type of advice that is provided to consumers.<sup>36</sup>

6.35 Mr Rowe, FPA, reinforced this message—'if a commission is bad for personal advice it is bad for general advice. If something is evil it is evil'.<sup>37</sup> He went on to state:

As we sit here today, and I think has been confirmed by Treasury, the drafting still allows for embedded product commissions to be reintroduced. We believe that can be fixed by defining what a commission is and banning it. We encourage the government to move in that direction.<sup>38</sup>

6.36 Thus, while generally in favour of the bill, the FPA could not support the proposed legislation if commissions on general advice remained. In its view, 'As the FOFA reforms were intended to protect consumers from unethical sales practices, the existing legislation creates unintended regulatory overreach'.<sup>39</sup> It recommended that additional amendments be made:

Sales commissions (both upfront and trailing) should be defined by the Corporations Act and banned with respect to financial product advice on superannuation and investment products.

General advice should no longer be a form of financial product advice, and instead should be re-termed 'factual information' or 'financial product information'.

Financial product information/factual information should be regulated with a warning similar to the general advice warning. This warning should make it clear that the information is not financial advice, it is information about a financial product or a class of financial products.

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34 *Proof Committee Hansard*, 22 May 2014, p. 23.

35 *Proof Committee Hansard*, 22 May 2014, p. 23.

36 *Proof Committee Hansard*, 22 May 2014, p. 20.

37 *Proof Committee Hansard*, 22 May 2014, p. 22.

38 *Proof Committee Hansard*, 22 May 2014, p. 23.

39 *Submission 15*, p. 7.

Licensing and all the other forms of regulation which currently apply to general advice should apply to financial product information/factual information.

The term Financial planner/adviser should be defined by legislation, in order to prevent individuals who offer financial product information/factual information from representing themselves as financial planners or financial advisers.<sup>40</sup>

6.37 The FPA recommended that the committee engage 'in close consultation with stakeholders on changes to the general advice terminology and definition'.<sup>41</sup>

6.38 Agreeing with FPA's contention, Mr Richard Webb, Australian Institute of Superannuation Trustees, indicated that there was probably room for a category of information that goes out there that certainly is not called 'advice' and is not confused by consumers as being advice.<sup>42</sup> He informed the committee that investors do not know the difference between terms such as information and advice and it was not good enough to suggest that they learn the difference:

...a lot of financial products are surprisingly more complicated than what people seem to think they are. A lot of the time we talk about basic deposit products as being simple. However, I am not a hundred per cent certain many investors are really familiar with how liquidity works with these products and how if you want an early withdrawal you are going to have to pay an interest adjustment plus a fee.<sup>43</sup>

6.39 In his view, the 'very notion that marginally different types of information should be the basis of different compliance remuneration regimes should be resisted, particularly when investors do not know the difference'. He argued that the opportunity for regulatory arbitrage was too great to ignore.<sup>44</sup>

6.40 The Association of Financial Advisers (AFA) was among the number of submitters very uneasy about the possibility of commissions creeping back as a form of remuneration through the provision of general advice. Mr Brad Fox, AFA, explained:

When we talk about the accessibility to advice, there are some circumstances where general advice is completely appropriate. If, for example, a client already has a super fund and rings the manufacturer or the owner of that super fund, and let's assume it is a bank, they would expect to be able to get some information about that product—not advice about what

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40 *Submission 15*, p. 7.

41 *Submission 15*, p. 7.

42 *Proof Committee Hansard*, 22 May 2014, p. 53.

43 *Proof Committee Hansard*, 22 May 2014, p. 52.

44 *Proof Committee Hansard*, 22 May 2014, p. 53.

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they should do within that product but advice about the product. For example, what is the administration fee? That is general advice.<sup>45</sup>

6.41 With regard to the exemption of general advice for conflicted remuneration, Mr Fox stated that the whole adviser marketplace has to be very clear on this matter. He was firm in his view that advisers licensed to provide personal advice on tier 1 products, which are the complicated products, should not be able to get commissions for general advice. But he believed that the exemption should go further stating that the AFA did 'not even think that bank tellers, for example, should be able to receive commissions for general advice'. Mr Fox stated that they should be able to be recognised for their job performance, but do not think they should get commissions on general advice.<sup>46</sup> He emphasised this point:

If someone were in a situation where they were not licensed to provide tier 1 personal advice—and the classic example would be a bank employee, an over-the-counter type situation—we would not want them to be receiving a fee, a percentage, for each individual sale of a product.

But, if you were the client coming in and I was the bank employee and I help you open a new super fund with our bank's product, I do not think I should get \$50 for that or one per cent of what you put into it. However, if I were doing a good job overall, and bringing in the balanced scorecard approach, then, yes, I should be able to be recognised for doing a good job...providing personal advice on tier 1 products should not be able to be remunerated for giving general advice.<sup>47</sup>

6.42 In his view, the drafting could be 'improved'. He informed the committee that AFA had been working with other stakeholders about how they might be able to do that and would continue to offer that support.<sup>48</sup>

6.43 According to CHOICE, the proposed additional exemptions would create 'further situations where conflicted remuneration is likely to impact on the quality of financial advice'.<sup>49</sup> CHOICE argued that the changes 'undermine the original FoFA reforms and place consumers at risk'. It did not believe that the protections were adequate. It referred to conditions that would restrict the general advice exemption to employees who had not provided advice to the person receiving the general advice in the past 12 months. In its view:

The twelve-month rule could be easily circumvented if one staff member provides advice and another sells the product. Additionally, consumers are

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45 *Proof Committee Hansard*, 22 May 2014, p. 4.

46 *Proof Committee Hansard*, 22 May 2014, p. 4.

47 *Proof Committee Hansard*, 22 May 2014, pp 4–5.

48 *Proof Committee Hansard*, 22 May 2014, p. 5.

49 *Submission 7*, p. 9.

still not likely to note a distinction between general and personal advice and may incorrectly believe that the advice provided is appropriate to them.<sup>50</sup>

6.44 Recently conducted research by CHOICE into consumer sentiment on the changes showed that 81 per cent of consumers were concerned that bank tellers would be able to sell complex financial products without assessing their personal needs and that they would earn a commission for doing so.<sup>51</sup> Mr Kirkland, CHOICE, explained that consumers were expected to work out whether they were receiving general advice and understand that there was 'a lower bar and should be more cautious'.<sup>52</sup> In his view, that was completely unrealistic:

That is one of the things we need to bear in mind when we are looking at things like the changes to conflicted remuneration that are contemplated here. It is just not realistic to expect the consumer to understand that distinction between personal and general advice.<sup>53</sup>

6.45 COTA was similarly concerned about situations where consumers were required to understand whether advice was personal or general. It told the committee that the abolition of conflicted remuneration for personal advice was 'one of the most important components of the package in terms of building trust in the financial planning industry'. It stated that one of its concerns with allowing conflicted remuneration was that:

...many people do not understand the distinction between personal and general advice and so may be susceptible to strong selling techniques, for example from bank staff. They may purchase products that are not appropriate for them but which they believe 'were recommended by my bank'.<sup>54</sup>

6.46 In its view, the protections outlined in the bill around the type of product and the distinction between provision of personal and general advice were not 'strong enough'. It cited CHOICE's research showing that 81 per cent of consumers were concerned about being sold complex products by bank tellers. COTA found that the feedback it received reflected CHOICE's research results.<sup>55</sup> COTA wanted to see:

...a robust professional financial advice industry further develop in Australia, in which the regular provision of independent and comprehensive advice becomes the norm not the exception. This is one component of improving financial literacy among people who for the first time, due to compulsory superannuation, will have significant retirement assets but who are not familiar with financial services and products. Allowing conflicted

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50 *Submission 7*, p. 10.

51 *Submission 7*, p. 10.

52 *Proof Committee Hansard*, 22 May 2014, p. 17.

53 *Proof Committee Hansard*, 22 May 2014, p. 17.

54 *Submission 10*, p. 5.

55 *Submission 10*, p. 5.

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remuneration for general advice will tend to skew incentives toward the provision of such advice rather than independent, comprehensive, fee based personal advice.<sup>56</sup>

6.47 Ms Campo, Industry Super Australia, referred to what she described as the rhetoric that supported this bill, which talks about the need to ensure that people can access assistance and advice, particularly from bank tellers. In the view of Industry Super, however, the exemption was not really about improved access:

There is already a complete exemption for basic banking products in the FoFA legislation. Therefore, what we are talking about is allowing commissions and other forms of conflicted remuneration to be paid on complex products, including superannuation but also others like managed investment schemes and leveraged products, which have been the subject of many previous inquiries due to the consumer losses that have ensued.<sup>57</sup>

6.48 Industry Super Australia was also worried that there were no disclosures in the general advice setting to consumers 'to put them on guard that they are not being given impartial general advice, that they are actually being sold something'.<sup>58</sup>

6.49 AIST explained that although the exemption would apply to general financial product advice provided to retail clients, it would apply to all financial products, whether they were relatively simple, such as basic banking products, or considerably complex, such as structured investment products or derivatives.<sup>59</sup>

6.50 The SMSF Professionals' Association of Australia Limited also opposed the amendments to provide a limited exemption from the ban on conflicted remuneration for general advice which is provided in a specific set of circumstances. It was strongly of the view that there was no room for conflicted remuneration in financial services, even where the financial advice being provided does not specifically take into account the consumer's personal circumstances.<sup>60</sup> It stated that remuneration models based on commissions or volume payments were contradictory to a financial adviser providing the best advice for the client, whether they provide personal or general advice. It believed:

...the best consumer outcomes must be achieved independently from any links with product remuneration. This should be achieved in an environment where remuneration is aligned with providing high quality advice and on a fee for service basis, not on a commission or volume basis

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56 *Submission 10*, p. 5.

57 *Proof Committee Hansard*, 22 May 2014, pp 55–56.

58 *Proof Committee Hansard*, 22 May 2014, p. 56.

59 *Submission 22*, p. 12.

60 *Submission 21*, p. 3.

which incentivises sale of products over the provision of objective, quality advice which is in the genuine interest of the client.<sup>61</sup>

6.51 SPAA also referred to the difficulty distinguishing between general and personal advice. It registered its concern that 'a limited exemption for general advice from the ban on conflicted remuneration is complicated by the blurring of the distinction between general and personal advice'. It stated:

By allowing general advice to receive conflicted remuneration, there is an incentive for advisors and dealer groups to push the limit of this distinction which has been misinterpreted to favour the advisor's position to the detriment of the client. This may have the result of consumers receiving personal advice that is paid for through commission based fees and not subject to the rigours that personal advice must stand up to (i.e. statement of advice and know your client obligations).<sup>62</sup>

6.52 The association made plain that 'increased access to general advice does not equate to consumers receiving financial advice which is appropriate, adequate or will assist them in making improved financial decisions'.<sup>63</sup> It warned that the amendments would result in financial institutions that provide financial products and advice—such as banks and superannuation funds—gravitating towards business models based around general advice. It suggested that this development would be 'at the cost of consumers who seek advice through a major financial institution'. In its views, such consumers would be 'pushed towards general advice which relates to the institution's products rather than receiving advice that addresses their needs'. If these amendments were introduced, SPAA's research suggested that this shift may encourage less engagement by consumers in their financial decisions. According to SPAA, this tendency may have an effect of 'encouraging greater vertical integration in businesses that provide both financial advice and financial products'.<sup>64</sup> It argued:

Allowing commission based remuneration for general advice in effect lowers the bar that was in place prior to the FoFA amendments and clients are in a worse position in relation to objective advice than they have been in the past. The outcome is a detrimental result for consumers. While the changes in the Bill may lower the cost of general advice in a limited set of circumstances they are likely to lead to an increase in the cost of personal advice.<sup>65</sup>

6.53 In summary, the SPAA believed that the amendments were likely to lead to poorer and more conflicted advice being delivered to consumers and, hence, there was a clear need for a clearer distinction to be made between what is financial advice and

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61 *Submission 21*, p. 3.

62 *Submission 21*, p. 4.

63 *Submission 21*, p. 3.

64 *Submission 21*, p. 4.

65 *Submission 21*, p. 4.

what is factual or sales information.<sup>66</sup> It recommended that the government delay any changes to the ban on conflicted remuneration until after the Financial System Inquiry delivers its report to the Treasurer and has considered alternative approaches to licencing financial advice.<sup>67</sup>

6.54 The Institute of Public Accountants was aware of the controversy around exempting general advice from the ban on conflicted remuneration in certain circumstances. It appreciated both sides to this argument.<sup>68</sup> It stated:

On the one hand, consumers who have done research and simply wish to purchase a product should be able to do so without having to pay for expensive or unnecessary (holistic) financial advice. This is part of scaled advice or making financial advice more affordable. On the other hand, some consumers may benefit from this advice, even though they may not wish to pay for it. This could lead to consumers purchasing the wrong products or being up-sold or cross-sold products, which arguably defeats the intention of the FoFA reforms.

In addition, giving an exemption to ADIs would provide them with an advantage and create an unlevel playing field. However, extending the exemption could undermine the objective of FoFA of removing the potential for conflicted remuneration.<sup>69</sup>

6.55 The institute was inclined to disagree with the proposed amendment but was of the view that the matter of exemption warranted more discussion and consultation.

### **Support for broadening exemptions from the ban on conflicted remuneration**

6.56 Minter Ellison Lawyers was of the view that product issuers or someone acting on their behalf giving general advice should be excluded from the ban on conflicted remuneration.<sup>70</sup> Mr Batten noted that FOFA's focus had 'always been on ensuring that clients receive advice on their circumstances which is free from any conflict arising from remuneration'. He explained further that the bill would only apply to advice that a client knows is general advice not tailored for them. He suggested:

Advice will only be general advice where a client could not reasonably think that their circumstances should be considered. So, in other words, if a client thinks they are getting personal advice then basically they are getting personal advice, and that means the prohibition will apply.<sup>71</sup>

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66 *Submission 21*, p. 5.

67 *Submission 21*, p. 6.

68 *Submission 16*, p. 4.

69 *Submission 16*, p. 4.

70 *Submission 18*, p. 3.

71 *Proof Committee Hansard*, 22 May 2014, p. 43.

6.57 Hence, Minter Ellison Lawyers did not believe that remuneration controls were needed for representatives of product issuers when not giving personal advice:

The issuer will be liable for any misleading or deceptive conduct and will therefore need to ensure that clients do not receive inappropriate general advice. Marketing brochures are an example of where the ban on conflicted remuneration should not apply. It adds costs without any benefit.<sup>72</sup>

6.58 Minter Ellison Lawyers observed that general advice can be given in many different circumstances, such as 'in brochures, on the internet, in correspondence and by call centre and branch staff'. It acknowledged that product issuers were 'naturally and appropriately concerned to promote their products'. In its view, however, there could be no doubt that retail clients expect them to do exactly that: in other words 'the provider's motivation is clear in each case'.

6.59 Thus, according to Minter Ellison, product issuers and their staff would 'have a strong interest in the success of their products however they are remunerated' and therefore there would be no need to regulate their remuneration.<sup>73</sup> They cited a number of key consumer protections that exist in relation to the conduct of product issuers and their representatives, including:

...the prohibition on misleading and deceptive conduct in ss 12DA and 12DB of the ASIC Act and ss 104IE and 104IH of the Corporations Act, the requirement to give general advice and advertising warnings in ss 949A and 1018A of the Corporations Act, restrictions on unsolicited contact with clients in ss 992A and 992AA of the Corporations Act and product disclosure requirements in Part 7.9 of the Corporations Act.<sup>74</sup>

6.60 Taking account of these provisions, Minter Ellison Lawyers submitted that these safeguards provided an appropriate and sufficient level of protection in relation to general advice.<sup>75</sup> They did, however, draw attention to the proposed exemptions in section 963B(6), noting that this exemption was limited to employees of licensed product issuers.<sup>76</sup> They stated:

In practice, it is unusual for product issuers or licensees to employ staff directly. In most corporate groups, a related service company will be the employer of staff for all or most companies in the group. Even in cases where a product issuer such as a bank is the group employer, the product issuer is unlikely to be the issuer of the particular products in question. For example, where a bank is the group employer, the bank will only issue banking products.<sup>77</sup> It suggested that s 963B(6) should be amended to: also

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72 *Proof Committee Hansard*, 22 May 2014, p. 36.

73 *Submission 18*, p. 3.

74 *Submission 18*, p. 4.

75 *Submission 18*, p. 4.

76 Item 29.

77 *Submission 18*, p. 4.



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apply to employees of related bodies corporate of the product issuer; and be extended to agents of the product issuer and others acting under the name of the product issuer.<sup>78</sup>

6.61 FSC supported the amendments that would 'permit remuneration to employees who provide services which, however remote from the consumer, may be deemed today as conflicted remuneration'.<sup>79</sup> It explained:

That is, the broad definition banning remuneration at section 963A catches within the ban employees who are not providers of advice or are providers of generally available information and general advice 'because of the nature of the benefit or the circumstances in which it is given'. That is, no matter how remote (the employee's work product is from influencing the choice of financial product and/or the advice eventually provided by an advice provider), remuneration including performance bonuses paid to an employee are nonetheless caught and banned by FoFA.<sup>80</sup>

6.62 In its view, this was clearly legislative overreach and highlighted that the balance between consumer protections (banning remuneration to create an advice over a sales culture) had 'swung too far and actually impedes basic information services consumers need'.<sup>81</sup>

6.63 The FSC understands that the intent of the provision in the bill was to enable a business to give general advice to retail clients on its own products, through its employees, and to leave the business free to reward those employees on a performance basis without the constraints of the prohibition on conflicted remuneration.<sup>82</sup> Mr Andrew Bragg, FSC, told the committee that from the council's viewpoint the drafting of the bill needs 'some more work', in terms of ring fencing and being very clear about what that exemption includes and what it does not. As an example, he stated that 'no-one wants to see commissions brought back'.<sup>83</sup> His colleague, Ms Cecilia Storniolo, reinforced this message that the general advice exemption 'requires extra ring fencing to make sure that it is clear that a financial adviser cannot receive those monies': that the proposed legislation does not allow the reintroduction of commissions.<sup>84</sup>

6.64 According to the FSC, the nomenclature in the law today is unhelpful especially with/for consumers. FOFA has not banned all forms of remuneration—but by drafting legislation which calls everything a conflicted payment the perception is

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78 *Submission 18*, p. 4.

79 *Item 29*.

80 *Submission 27*, p. 28.

81 *Submission 27*, p. 28.

82 *Submission 27*, p. 28.

83 *Proof Committee Hansard*, 22 May 2014, p. 86.

84 *Proof Committee Hansard*, 22 May 2014, p. 87.

created such that even permissible or exempted payments/benefits are perceived to be conflicted.<sup>85</sup> The FSC recommend that consideration be given to rename:

- section 963B—'Monetary benefit given in certain circumstances not conflicted remuneration' as 'Permissible monetary benefits,' and
- section 963C—'Non-monetary benefit given in certain circumstances not conflicted remuneration' as 'Non-monetary benefits'.<sup>86</sup>

6.65 The Stockbrokers Association of Australia was also concerned that the conflicted remuneration provisions originally applied to the provision of both general and personal advice. In its view, extending the scope of FOFA to general advice 'unnecessarily complicated the implementation and administration of the regime' and 'went well beyond the original intention behind FOFA'. From its perspective, the inclusion of general advice in the FOFA provisions made the scope of the prohibition so broad as to make it unworkable. In support of the amendment, it suggested that:

By definition, **general advice does not take into account a person's needs or objectives** so it is not appropriate to apply a conflicted remuneration regime when a recommendation is not being made based on the person's individual circumstances.<sup>87</sup>

6.66 Ms Diane Tate, Australian Bankers' Association, explained that the banks were endeavouring to make sure that they could continue to provide general advice without having to have convoluted, complex and costly compliance in the background. In her view, such complicated and expensive compliance could prevent banks from being able to provide the freely available information that they do now.<sup>88</sup> She informed the committee that bank staff were not paid commissions but a salary and may have access to a performance bonus based on a balanced scorecard. According to Ms Tate, the banks were:

- not seeking to reintroduce or charge commissions; or
- not trying to gut or dilute the best interests duty.

6.67 In her words, the banks were trying to:

...get some clarity and simplicity to that so that it does not cut across our attempts to be able to provide more relevant and targeted information—call that 'scaled advice' if you like, but it is personal advice that is relevant to the circumstances of customers.<sup>89</sup>

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85 *Submission 27*, p. 28.

86 *Submission 27*, p. 28.

87 *Submission 4*, p. 2 (emphasis in original).

88 *Proof Committee Hansard*, 22 May 2014, p. 75.

89 *Proof Committee Hansard*, 22 May 2014, p. 75.

6.68 The ABA also underlined the fact that general advice, by its nature, does not take into account an individual's relevant circumstances and must contain a warning to that effect. It may be provided directly via employees and staff or indirectly via brochures or websites (or other electronic interfaces). According to the ABA:

We consider that the availability of general advice is important for consumers to help them better understand financial products and services, and the options available to them in an affordable manner and through a variety of access channels. This information and general advice is important to lift levels of financial literacy and engagement. It is also important for product issuers to be able to provide information and advice about their own financial products and services. Consumers readily expect this in their customer service interactions with a bank or other product issuer.<sup>90</sup>

6.69 The ABA supported a limited carve out for general advice which aimed to:

- confine the exemption to employees and staff—a person working exclusively under the name or brand of the licensee—and preparing or giving general advice on the financial products of their licensee or a related body corporate of the licensee;
- prohibit the person also providing personal advice on financial products, other than products already exempt, being basic banking products, general insurance products and consumer credit insurance ('Tier 2 products'); and
- prohibit the person receiving a monetary benefit commonly referred to as an upfront or ongoing commission.<sup>91</sup>

6.70 Ms Meghan Quinn, the Treasury, stated bluntly that the intention was not to have commissions but 'to make sure that not absolutely everybody who is ever answering a question on the telephone is covered by the legislation'.<sup>92</sup> Her colleague, Mr Tee, noted that the Corporations Act mentions commissions a few times but does not actually provide a definition of commission. He added that the matter of commissions was one of the issues that Treasury was working through.<sup>93</sup> Mr Bede Fraser, the Treasury, informed the committee that the government was still open to amendments to achieve the policy intention, particularly 'around the content of allowing commissions'. He stated that the government was 'currently engaging with people to ensure that the general advice provision would not allow the reintroduction of commissions'.<sup>94</sup>

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90 Australian Bankers' Association, *Supplementary Submission*, p. 2.

91 Australian Bankers' Association, *Supplementary Submission*, p. 2.

92 *Proof Committee Hansard*, 22 May 2014, p. 93.

93 *Proof Committee Hansard*, 22 May 2014, p. 94.

94 *Proof Committee Hansard*, 22 May 2014, p. 93.

## **Conclusion**

6.71 Clearly, a number of submitters lodged strong objections to the amendments broadening the exemptions from conflicted remuneration. They came not only from consumer protection groups but from industry groups including CPA Australia and the Institute of Chartered Accountants Australia, FPA, the Australian Institute of Superannuation, AFA, FPSA, and SPAA. The term 'commission' was often used with reference to the original objective of the FOFA reforms, which was to put an end to such practices.

6.72 Those in support of the amendments, however, noted that the current arrangements captured people or circumstances that were never intended to be subjected to the ban on conflicted remuneration. Furthermore, they stressed that the exemption related to general advice only and not personal advice. The bill's intention is to enable a business, under certain circumstances, to give general advice to retail clients on its own products. Even so, the FSC, which supported the amendments, recognised the need 'for more work' to be done on the drafting, which 'requires extra ring fencing' to ensure that the proposed legislation does not allow the reintroduction of commissions'. Indeed, Treasury officials indicated that commissions 'was one of the issues that Treasury was working through'.

6.73 The committee accepts that the current law needs to be changed to remove the unnecessary complications associated with the provision of general advice. In this regard, the committee is concerned about the confusion that surrounds the proposed changes and the fear that they have the potential to reopen the door to commissions. The committee also notes the concerns about the possible misuse or misunderstanding of the term 'general advice'.

6.74 A number of witnesses held the view that the legislation still required more work. The IPA believed that the matter of exemptions 'warranted more discussion and consultation'. The AFA suggested that the drafting could be improved and it was collaborating with stakeholders to see how they could achieve that objective. The FPA noted that while it did not think that the legislation intended to allow the return of commissions, in its view the current drafting provided no such assurance. The FSC referred to the general advice exemption requiring 'extra ring fencing' to make sure that it was clear that an adviser could not receive commissions. The SPAA suggested that the government delay any changes to the ban on conflicted remuneration until after the Financial Systems Inquiry. The Institute of Chartered Accountants would like to see more detail on this matter of exemptions to the ban on conflicted remuneration. Even the Treasury suggested that it was open to amendments.

## **Recommendation 2**

**6.75 The committee recommends that the Explanatory Memorandum make clear that it is not the government's intention to reintroduce commissions.**

**6.76** The committee recommends that the government consider the provisions governing conflicted remuneration and redraft them to ensure that there is greater clarity around their implementation.

**6.77** The committee recommends that the government give consideration to the terminology used in the Explanatory Memorandum and legislation (for example, section 766B), such as information, general advice and personal advice, with a view to making the distinction between them much sharper and more applicable in a practical sense when it comes to allowing exemptions from conflicted remuneration.

