Chapter 5

Bans on conflicted remuneration

5.1 The committee's inquiry into financial products and services in Australia noted that the financial advice industry originated as a cohort of sales staff representing financial product manufacturers. Advisers were remunerated based on the value of products sold and their fee was deducted from the amount paid by the consumer for the product. The origins of the industry, however, do not align with contemporary consumer expectations that financial advisers provide a professional service acting in the best interest of their clients. In the current market, advisers typically play a dual role of providing advice as well as acting as sales representatives for financial product manufacturers.[1]

5.2 Up-front commissions, charged as a percentage on the initial investment, and trail commissions, charged at ongoing intervals as a percentage of assets, are a common form of benefit provided to advisers. In some cases, advisers will encourage consumers to gear their investment portfolios (use borrowed funds) to enable the adviser to increase the benefit of asset-based fees.[2] This creates a clear conflict of interest between adviser and consumer and has a negative impact on the quality of advice provided. In the collapse of Storm Financial, for example, it was found that in some cases there was insufficient consumer understanding of the risk of borrowing against the equity of a family home.[3]

5.3 The Australian Securities and Investments Commission (ASIC) outlined some of the features of commissions:

> The distinguishing feature of commissions is that they are an arrangement between the product issuer and the adviser or the adviser's licensee and they are built into the product. That is, the commissions are incorporated into the fees paid by the client to acquire or hold the product. After the investor has invested in the product, the investor cannot control the commission.
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> Commissions as a 'built in' feature of products also distort the cost of advice. Retail clients are unaware of the true cost of receiving personal financial advice as this is often bundled into the overall fees they pay for financial products.

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1 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 69–70.

2 The Treasury, *Submission 22*, p. 9; Joint Consumer Groups, *Supplementary Submission 25*, pp 9–10.

3 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p. 28.

> Because the commission is built into the product, it is often difficult to draw a link between the commission and the advice service provided. For example, industry argues that trail commissions are in effect payment for ongoing advice services provided to the client or ongoing administrative costs, for example, the costs of monitoring the client's portfolio. However, trail commissions are often paid regardless of whether there is any ongoing advice or service.[4]

5.4 Conflicts of interests can also arise where advisers are authorised representatives of a licensed advisory group owned by a product manufacturer, creating a vertically integrated model.[5] Consumers are not necessarily aware of this relationship and of the inherent conflicts of interest that will arise.

5.5 An additional element in the chain of commission-based payments is the platform operator which can act as a conduit for various product providers to licensees. A product manufacturer will pay a volume-based shelf-space fee, to the platform operator to receive preferential treatment for their product when the operator is interacting with licensees.[6] The fee amount paid by a product manufacturer is wholly, or partly, determined by the total number or value of products listed with the platform operator.[7] The consumer, when offered and subsequently purchases a financial product, is unlikely to be privy to the incentives offered to either the platform operator or the adviser.[8]

5.6 The bans on conflicted remuneration target the effect of these sales-incentives on the quality of advice.

5.7 The second tranche of the FOFA Bills, the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bill) amends the *Corporations Act 2001* (the Act) to ban the payment and receipt of certain remuneration which could influence the advice licensees provide to consumers in relation to financial product advice.[9] Payments banned include:

- commissions;
- volume payments from platform operators to financial advice dealer groups;
- volume-based shelf-space fees paid by funds managers to platform operators;

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4 Australian Securities and Investments Commission, *Supplementary Submission 28*, p. 13.

5 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, pp 75, 79.

6 Jennifer McDermott, 'What's that: Shelf-space fees', *The Australian*, 9 June 2010.

7 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Subsection 964A(2).

8 Joint Consumer Groups, *Supplementary Submission 25*, pp 8-9.

9 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

- asset-based fees on borrowed amounts; and
- soft dollar benefits over an amount prescribed by regulation (proposed to be $300), as long as the benefits are not identical or similar and provided on a frequent or regular basis.[10]

5.8 The Explanatory Memorandum (EM) outlines that Australian Financial Services Licensees (AFSLs) are remunerated differently from many other occupations and that traditionally advisers have received commissions from product providers for placing clients with particular products:

> 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.
>
> There is some evidence that these conflicts affect the quality of advice. The 2006 Shadow Shopping exercise of the Australian Securities and Investments Commission (ASIC) found that advice that was clearly or probably non compliant was around six times more common where the adviser had an actual conflict of interest over remuneration. The conflict of interest may lead to advice that is not compliant and not in the client's interests.[11]

Exceptions from conflicted remuneration

5.9 As noted in chapter 2, there are some exceptions to the bans on conflicted remuneration including:

- general insurance;
- life insurance which is not bundled with a superannuation product;
- group life policies for members of a superannuation fund;
- individual life policies which are not connected with a default superannuation fund;
- execution-only (non-advice) services;
- non-monetary benefits in relation to general insurance;
- soft-dollar benefits under the amount prescribed by regulation (proposed to be $300);
- soft-dollar benefits with an education or training purpose (to be clarified in regulation);

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10 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 7, 30–31.

11 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

- soft-dollar benefits that provide information technology software or support;[12] and
- employees or agents of an Authorised Deposit-taking Institution (ADI) that are providing advice on basic banking products.[13]

5.10 Volume-based payments will also be excepted where it can be proven that the benefit of the payment is not conflicted (see paragraph 5.24).

5.11 It is also proposed that regulations will address stockbroking activities where a person receives third party 'commission' payments from companies when the payments relate to capital raising be excluded from the bans on conflicted remuneration (discussed further in chapter 7, paragraph 7.42).[14]

5.12 The following matters are discussed in this chapter:

- Volume-based rebates;
  - the impact on bank tellers;
  - the impact on corporate superannuation;
- risk insurance inside superannuation;
- asset-based fees on borrowed amounts; and
- grandfathering.

Submitters' views

5.13 There was broad support among industry participants for the ban on conflicted remuneration and the government's policy goals of improving the integrity and professionalism of the industry and increasing consumer confidence in financial planners. There is, however, some disagreement on the proposed conflicted remuneration provisions and the related carve-outs. These views are discussed below.

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12 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 24.

13 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 33.

14 Subject to further consultation, it is proposed that the receipt of 'stamping fees' from companies for raising capital on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market.
Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 30.

General advice

5.14 The Australian Bankers' Association (ABA) noted that while the best interests duty relates only to personal advice, the conflicted remuneration provisions apply to benefits on personal advice, general advice and the distribution of financial products.[15]

5.15 The Superannuation Committee of the Law Council of Australia voiced concerned that the definition of conflicted remuneration is 'defined in very general terms' and is not limited to remuneration for personal advice:

> Any fee or charge may be conflicted remuneration under the general definition in section 963(1) if the licensee or its representative provides financial product advice to a retail client which could have the necessary influence. For example, a product issuer who provides general financial product advice (for example in the form of a product disclosure statement), could be prohibited by the ban on conflicted remuneration from receiving a management fee as the fee could be interpreted as being capable of influencing its general advice to investors. It could also prevent trustees of superannuation funds paying fees based on assets under administration or the number of members to fund administrators (who also provide general or personal advice to members).[16]

5.16 The Law Council has requested that product and service fees accumulated as a result of general advice be specifically excluded from the definition of conflicted remuneration in the forthcoming regulations.[17]

5.17 The Financial Services Council (FSC) and the ABA noted that by definition, general advice must be accompanied by a warning that the advice does not consider the clients' individual personal circumstances, and the client should consider their personal circumstances and the accompanying disclosure documents before making a decision.[18] FSC submitted that general advice is:

- 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;
- far less influential on the decision of a retail client than personal advice; and
- not the context in which the issues and concerns referred to in the Explanatory Memorandum arise.[19]

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15 Australian Bankers' Association, *Submission 67*, p. 10.

16 Law Council of Australia, *Submission 5*, p. 9.

17 Law Council of Australia, *Submission 5*, p. 9.

18 Australian Bankers' Association, *Submission 67*, p. 10; Financial Services Council, *Submission 58*, p. 76.

19 Financial Services Council, *Submission 58*, p. 76.

5.18 The ABA recommended that the bans on conflicted remuneration should not apply to general advice; rather, it should encourage the use of scaled advice. ABA asserted that general advice is an important element in filling the financial advice gap for many Australians.[20]

5.19 Further, the FSC highlighted that general advice is included in broadcasts and media advertising, newsletters, websites, seminars, product brochures (such as a product disclosure statement), call-centre operations and billboards. In addition, it may not be product specific and has a broader educational or informative purpose.[21]

5.20 The FSC submitted that exemptions for general advice are required given the low threshold for determining whether the benefit might influence advice.[22] ABA also suggested that regulations should prescribe an exemption for general advice in relation to basic financial products, including simple super products, simple wealth products, and retirement savings accounts.[23]

Committee view

5.21 The committee considers that the bans on conflicted remuneration should apply to general advice and that advisers can utilise a fee-for-service model when offering this form of advice.

Volume-based rebates

5.22 Currently, employers can pay incentives to advisers to sell a certain type or a certain volume of products. The Bill proposes to prohibit volume-based shelf-space fees paid by funds managers to platform operators and volume payments from platform operators to financial advice dealer groups.[24]

5.23 One of the key concerns with the ban on volume-based remuneration was the impact it would have on competition in the market, and the risk that dealer groups would restructure their enterprises into vertically integrated models to retain the income that they otherwise would have received from volume rebates. These concerns, and the anti-avoidance provisions designed to address them, are discussed further in chapter 6.

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20 Australian Bankers' Association, *Submission 67*, p. 11.

21 Financial Services Council, *Submission 58*, p. 76.

22 Financial Services Council, *Submission 58*, p. 76.

23 Australian Bankers' Association, *Submission 67*, p. 39.

24 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 25–26, 35–36.

Volume-based fees as a fee for service or scale efficiencies

5.24 A benefit is presumed not to be a volume-based shelf-space fee if it is proved that all or part of the remuneration is a fee for service or a discount that does not exceed the reasonable value of scale efficiencies:

> The Bill assumes that the platform operator will be aware of the nature of any discount or rebate it receives, and will therefore be aware of whether a payment is a genuine fee for service, or represents genuine scale efficiencies. It is therefore appropriate that the platform operator bear the onus of proving that the payment ought to be presumed not to be a volume-based shelf-space fee.[25]

Calls for greater restrictions on platform fees

5.25 The Joint Accounting Bodies (JAB) believed there is a risk in allowing volume-based shelf-space fees in instances where it is proven that all or part of the remuneration is a fee for service or a discount that does not exceed the reasonable value of scale efficiencies. JAB suggested that, alternatively, platform operators should only be able to receive an asset management fee discount in the form of a rebate where it represents a reasonable value of scale efficiencies. JAB argued that the value of the rebate should be passed on to clients invested in the respective fund manager.[26]

5.26 The Joint Consumer Groups (JCG) argued that non-volume-based benefits paid to secure preferential treatment on a platform should not be allowed:

> Flat fee payments, especially if very large and bearing no relation to the costs of the platform operator, could easily distort product recommendations given to retail clients. For example, the payment of such a fee by a particular product issuer may lead to increased recommendations to acquire the products of that issuer, in much the same way that, in the past, high commissions have lead to recommendations to acquire certain products.[27]

5.27 JCG recommended that the ban should include 'any other benefit provided by a product to a platform operator, other than:

- fees for services provided by the platform operator which reasonably represent the market value of those services;
- the purchase price for property which reasonably represents the market value of the property; and

25 Treasury, *Submission 22*, p. 9, see also Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 36.

26 Joint Accounting Bodies, *Supplementary Submission 23*, p. 5.

27 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

- genuine education or training benefits'.[28]

5.28 Should the above amendment not be made, JCG recommended that the Bill require ongoing, public disclosure of all payments by product providers to platform operators on a publicly accessible website.[29]

5.29 In his Second Reading Speech, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, outlined that it would be in the interest of advisers to act prudently when determining whether remuneration could be considered to influence their advice:

> If an adviser is confident that a particular stream of income does not conflict advice, then these reforms do not prevent them from receiving that income. For example, in the case of the receipt of income related to volume of product sales or investible funds, there is a presumption that that income would conflict advice. However, this is a presumption only, and if the adviser can demonstrate that the receipt of the income does not conflict advice then such remuneration will be permissible under the bill.
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> But the message is clear—if in doubt about whether certain remuneration will conflict the advice that they provide to their client—the adviser would be prudent to err on the side of caution.[30]

Proving fee for service and value of scale efficiencies

5.30 The Superannuation Committee of the Law Council of Australia was concerned with the provision that certain benefits are conflicted remuneration unless proven otherwise:

> While the Committee agrees that not all volume based benefits are conflicted remuneration, it has a real concern about how the section will operate in practice. On what basis can it be proved that a volume based benefit is not conflicted remuneration and to whom? Read literally, a volume based benefit will be conflicted remuneration until such time as it is proved not to be. In the Committee's opinion, the provision does not give any certainty to the industry or to employers.[31]

5.31 The FSC believed the current drafting of subsection 964A(2), which defines a volume-based shelf-space fee, does not permit genuine dollar-based shelf-space fees charged by platform operators.[32] Further, Westpac is concerned that it will be an

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28 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

29 Joint Consumer Groups, *Supplementary Submission 25*, p. 9.

30 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 24 November 2011, p. 13752.

31 Law Council of Australia, *Submission 5*, p. 10.

32 Financial Services Council, *Submission 58*, p. 63.

impossible task for a platform to ascertain and prove the value of scale efficiencies of a fund manager:

> ...the way that section 964A(3)(b) is drafted, the onus is on the platform to prove the efficiencies gained by the fund manager which is difficult, if not impossible. Discounts and rebates will differ across the funds management industry as each will have different economies of scale across different asset classes. In addition, the fund manager's economies of scale can differ depending on the platform (e.g. services the platform takes on, technology interfaces between the platform and fund manager). The discount is also subject to confidential and commercial negotiations between the fund manager and platform and may differ depending on the bargaining power of either party.[33]

5.32 The Law Council recommended that a materiality threshold should be included in the Bill, and a ruling system for ASIC to determine which benefits are deemed conflicted remuneration and which are not.[34] Westpac also suggested that legislative guidance on how to prove that efficiencies have been gained by the funds manager should be provided. It suggested a reasonable option could be a bona fide arms length negotiated agreement between the funds manager and the platform operator.[35]

5.33 FSC recommended that subsection 964A(2) be amended to ensure annual or one-off dollar based fees (not related to volume) that are operational in nature be carved out from the definition of a volume-based shelf-space fees.[36]

5.34 The EM outlines that, when determining a reasonable value of scale efficiencies, regard should be given 'to what might be reasonable in all the circumstances, including, for example, the relative bargaining power between the particular funds manager and the platform operator'.[37]

Committee view

5.35 The committee acknowledges the calls from industry for greater certainty in determining which volume-based fees will be permitted under the Bill. It recommends that Treasury establish a materiality threshold in the regulations to outline what percentage of a volume-based fee constitutes a genuine value of scale efficiencies and what constitutes 'a reasonable fee for service'. Further, the regulations should require product providers to publicly disclose permissible volume-based payments made to

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33 Westpac Group, *Submission 64*, p. 26.

34 Law Council of Australia, *Submission 5*, p. 10.

35 Westpac Group, *Submission 64*, p. 26.

36 Financial Services Council, *Submission 58*, p. 63.

37 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 36.

platform operators on their websites, and financial advisers should disclose volume-based benefits received in product disclosure statements.

5.36 In addition, the committee recommends that ASIC issue guidance material on how licensees can prove that efficiencies have been gained when in receipt of a volume-based benefit. This may include written agreements between product providers and platform operators which outline genuine value of scale efficiencies, or a reasonable fee for service framed around requirements specified in the regulations.

Recommendation 5

5.37 The committee recommends that regulations pertaining to paragraph 964A(3) of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be drafted to include a materiality threshold to determine when a benefit is not presumed to be a volume-based shelf-space fee. The regulations should specify that full disclosure is required for the payment and receipt of these benefits.

Recommendation 6

5.38 The committee recommends that the Australian Securities and Investments Commission (ASIC) issue guidance material for platform operators who seek to substantiate a claim that a volume-based payment demonstrates a reasonable fee for service or a genuine value of scale efficiencies.

Impact on bonuses for bank tellers

5.39 ABA submitted that the ban on volume-based fees could be interpreted to prohibit the payment of performance bonuses for bank staff, as performance bonuses relate to volume, or in some cases, an aggregate net improvement in their client's net position:

> The ABA submits that performance pay for bank employees is beyond the policy intent of the FOFA reforms. Furthermore, it does not automatically follow that a client is at risk of receiving advice which is conflicted merely because an adviser may receive part of their remuneration in the form of a performance bonus payment from their employer based on their overall activities for the year and the overall service provided to retail clients.[38]

5.40 ABA submitted that the structure of performance-based remuneration can be designed to foster productivity, innovation and efficiency, industry competiveness and global competiveness.[39] In addition, banks use a balanced scorecard approach which uses both financial and non-financial measures to determine incentive eligibility:

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38 Australian Bankers' Association, *Submission 67*, p. 25.

39 Australian Bankers' Association, *Submission 67*, pp 25–26.

> Incentive plans or variable rewards schemes can be based on a balanced scorecard approach where performance outcomes and behaviours are measured, such as customer satisfaction and quality (based on proxies used to ensure product sales meet customer needs and the product is used), community engagement, culture and employee management, self-development, financial and risk management, strategic process and quality, and revenue (based on individual or overall team performance). Measures are both financial and nonfinancial. The actual percentage of a scorecard relatable to a revenue measure varies from bank to bank, function to function, and individual to individual.[40]

5.41 ABA believed that bonus arrangements for bank staff should not be considered conflicted remuneration where incentive plans are not specifically volume-based, or 'wholly and directly linked to specific sales targets of a class of products, or where individual sales volume does not solely determine the incentive payment'.[41]

5.42 ABA recommended that the Bill should be amended to exempt volume-based payments that are not 'wholly or directly' (rather than 'wholly or partly') related to the value or number of financial products and argued that:

> In the absence of amendment and clarification, this could result in all bank staff not being rewarded and the removal of certain discretionary incentive structures, including performance bonus payments based on balanced scorecard methodology.[42]

5.43 ANZ noted that the EM 'appears to recognise the balanced scorecard approach as an acceptable remuneration arrangement':[43]

> If an employees is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to the volume is presumed to be conflicted. However, if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of the financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned.[44]

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40 Australian Bankers' Association, *Submission 67*, p. 26.

41 Australian Bankers' Association, *Submission 67*, p. 27.

42 Australian Bankers Association', *Submission 67*, p. 28. S963L of the Bill states that a benefit is conflicted unless it 'is *wholly or partly* dependent on the total value of financial products of a particular class'.

43 ANZ Wealth, *Supplementary Submission 29*, p. 5.

44 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 28.

Committee view

5.44 The committee believes that the carve-out from the conflicted remuneration bans for Authorised Deposit-taking Institutions (ADIs) providing advice on basic banking products is sufficient to allow for current performance-based remuneration structures in ADIs to continue.

Impact on corporate superannuation

5.45 Another group claiming they will be adversely, and unintentionally, affected by the ban on volume-based fees are the corporate superannuation specialists. This group engage in contracts with employers, providing newsletters and offer seminars in the workplace to educate employees.[45] Less than 10 per cent of corporate super specialist firms receive remuneration directly from their employer, the remainder receive income from the fund managers.[46] The Corporate Superannuation Specialist Alliance (CSSA) outlined that employers prefer the current form of remuneration for corporate super specialists and do not want an additional expense on top of their super contributions.[47]

5.46 The Boutique Financial Planning Principals Group (BFPPG) detailed its experience with several thousand members of corporate super funds totalling more than $100 million and an average member balance of $30,000. The BFPPG commented that 'the most efficient, cost effective way of being remunerated is through platform fees'. The BFPPG argued that without the services of corporate super specialists, the responsibility will fall back on the trustee who will have to increase administration fees to provide cover for their members, and as a result there will be no cost saving for consumers.[48]

5.47 The BFPPG also raised concerns that the measure will remove corporate superannuation specialists' services from the market and argued that this 'goes directly against government's stated aim of promoting choice and enabling access to quality advice at a low cost':

> Removing that ability to be remunerated will result in an inability to service clients, members will be predominantly invested in the fund’s default option, with little or no understanding of their super, little or no opportunity to salary sacrifice, unaware of co-contributions or transition to retirement

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45 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 79.

46 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 81–82.

47 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77. For further assertions on the lack of transparency in intra-fund advice see Financial Services Council, *Submission 58*, pp 70, 73–74.

48 Boutique Financial Planning Principals Group, *Submission 48*, p. 8.

> strategies and with no inclination or interest in investing more into their super since there will be no one to advise them.[49]

5.48 The CSSA is made up of over 50 firms.[50] It was formed in response to the proposed reforms in the sector and concern that corporate superannuation specialists would unintentionally be caught by restrictions intended for financial planners. CSSA was also concerned that the proposed reforms will jeopardise the viability of the services they offer:

> One reason the fees are so low in this sector of the superannuation industry is that we have negotiated on behalf of our clients to reduce the fee they pay. We also negotiate lower insurance premiums and higher levels of the automatic insurance cover which people get. This assists many people to get insurance cover which they may not otherwise be eligible for. We provide proactive financial education, advocacy and services delivered to the workplace. We believe the services we are providing fit perfectly with the government's goal to assist more people to seek financial advice, to be financially independent and to reduce dependence on social security, therefore creating less of a burden for future generations of taxpayers. Why then does the proposed legislation not provide a method for us to be paid for our valuable services? Why must we be forced into extinction?[51]

5.49 CSSA went on to state that if payments are channelled into an administration fee paid by a fund, rather than an ongoing commission, the fee for service will be hidden in the costs of the intra-fund advice[52] of fund managers:

> The only possible option is to revert to what ultimately looks like another form of commission and that is for us to be paid by the super fund trustees as part of the totally untransparent intrafund advice fee. We believe that any fee paid to us should be explicit and transparent and should be agreed between the party providing the service, being us, and the party receiving the service, being our clients.[53]

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49 Boutique Financial Planning Principals Group, *Submission 48*, p. 8.

50 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 81.

51 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77.

52 Intra-fund advice is personal financial advice without a full 'know your client' process. The advice must relate only to a member's account within the superannuation fund. Intra-fund advice can be provided over the phone, via email or face-to-face. Under the intra-fund advice rules, a super fund cannot provide advice on switching super funds, advice on financial products outside super, or advice on general retirement planning. SuperGuide: Simple independent superannuation information, 'Intra-fund advice', http://www.superguide.com.au/superannuation-topics/intra-fund-advice (accessed 3 February 2012).

53 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 77. For further assertions on the lack of transparency in intra-fund advice see Financial Services Council, *Submission 58*, pp 70, 73–74.

5.50 CSSA argued that its member firms provide a service that cannot be compared to the education, or general advice, services provided by fund managers that are in a vertically integrated model. It argued that if consumers are forced to deal directly with product providers, they will find it much more difficult to receive unbiased advice, particularly in the case when they opt to pay an additional fee for personal advice. In this case it would be 'unlikely that, for example, an AMP employee will recommend a product from MLC'.[54]

Committee view

5.51 The committee considers that corporate superannuation specialist firms promote choice in the market and these valuable services should continue to be provided. The committee emphasises that employers may choose the form of remuneration most suitable to their circumstances following the reforms.

5.52 The committee believes that corporate superannuation specialist firms should continue to receive benefits where they represent a 'reasonable fee for service' or a value of scale efficiencies.[55]

5.53 The committee proposes that Treasury conduct further consultation with the corporate superannuation specialists firms to discuss alternative viable models of remuneration that align with the FOFA reforms.

Risk insurance inside superannuation

5.54 Remuneration for general insurance and life insurance products outside superannuation are allowed under the provisions of the Bill. However, the following forms of remuneration are considered conflicted:

- group-life insurance bundled with superannuation; and
- life insurance bundled with default superannuation.

5.55 The National Insurance Brokers Association of Australia (NIBA) stated that the focus of the reforms has been financial planning and wealth management, not risk insurance. As a result the 'risk insurance industry has not had the opportunity of a review similar to that undertaken in relation to...the financial advisory industry'.[56]

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54 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 78 (see also see also pp 80–81 for a discussion on the difference between personal and general advice).

55 See paragraph 964A(3)(b) of the bill, which describes a value of scale efficiencies as 'a discount on an amount payable, or a rebate of an amount paid, to the funds manager by the platform operator, the value of which 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 in relation to which the funds manager provides services to the platform operator, or through the platform operator to another person'.

56 National Insurance Brokers Association of Australia, *Submission 59*, p. 4.

NIBA highlighted that no evidence has been provided to warrant significant reforms to the risk insurance industry:

> A recent industry review by ASIC found no such problems and the regime (effectively Chapter 7 of the Corporations Act and general law) is working well for insurance brokers and their retail clients. In particular, this is evidenced by the low level of disputes referred to the Financial Ombudsman Service (FOS) in relation to insurance brokers. Insurance brokers are effectively being tarred by the same brush as financial advisers for no good reason.[57]

5.56 NIBA also emphasised that insurance products can be complex and difficult to understand, and that the services of a professional adviser can assist consumers to get the coverage they need at an appropriate price, and in turn reduce claims issues.[58]

Increased levels of underinsurance?

5.57 Some submitters argued that bans on life insurance inside superannuation will increase levels of underinsurance in Australia.[59] IOOF Holdings commented:

> A vast majority of the population settle for the default insurance cover provided within their default super fund and are, consequently, under-insured. Those that do seek advice obtain appropriate levels of cover most typically through group life insurance arrangements. The ability to pay commissions from inside super rather than having to pay from after-tax salary is a primary reason for those who do accept to be advised on risk insurance. The removal of risk insurance commissions inside super will exacerbate the existing under insurance situation in Australia.
>
> Fee for service with adviser-driven insurance presents practical challenges. Imagine a situation where an adviser must do significant work, and so charge the client at the time a claim is lodged following the death or injury of the client's partner.[60]

5.58 The Association of Financial Advisers (AFA) put the view that risk insurance inside superannuation should remain outside the FOFA remuneration changes on the grounds that is has a similar set up to general insurance type products (which are exempt from the bans), it has an annual renewal period and a defined benefit/risk.[61] Accordingly, the AFA recommended:

> ...that this area be the subject of greater research and investigation. In the context of corporate superannuation and group life insurance, there needs to

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57 National Insurance Brokers Association of Australia, *Submission 59*, p. 5.

58 National Insurance Brokers Association of Australia, *Submission 59*, p. 6.

59 FYG Planners Pty Ltd, *Submission 50*, p. 2; National Insurance Brokers Association, *Submission 59*, p. 6.

60 IOOF Holdings Limited, *Submission 19*, p. 4.

61 Association of Financial Advisers, *Submission 66*, p. 11.

> be a comprehensive review of the current model across retail, corporate and industry fund superannuation plans. Consideration needs to be given to a sensible alternative remuneration model for insurance arrangements, where advice is provided.[62]

Committee view

5.59 The committee believes a fee for service model is appropriate when advice is provided for risk insurance products bundled with superannuation products. For example, in the case where a client is required to pay a fee for service after lodging a claim for the death or injury of a partner, the Bill allows for the fee for service to 'be given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client'.[63] Namely, the client can direct that the fee for service be taken from the client's investment, or product issuer in the case where they do not choose to pay the fee directly.

Remuneration on all risk insurance products should be banned

5.60 The Industry Super Network (ISN) argued, however, that commission on all personal risk products should be included in the ban, including those outside superannuation.[64] JAB agreed and argued that the carve-out for insurance outside superannuation 'encourages the retention of conflicted remuneration models':[65]

> We believe the inconsistency in how commissions on insurance for life risk products sold outside of superannuation and individual life risk policies within superannuation for non-default funds adds unnecessary complexity. Further, it encourages the retention of conflicted remuneration models. All payments deemed to be conflicted remuneration should be regulated consistently.
>
> Choosing to not ban conflicted remuneration on life risk insurance products in these specific circumstances, irrespective of the best interests obligation, risks the continued provision, perceived or real, of inappropriate advice to consumers who seek advice on these products.
>
> The Joint Accounting Bodies do not believe there are sufficient grounds to warrant these products being excluded from the regulation proposed to apply to other like products. Such 'carve-outs' add complexity and cost to the provision and administration of advice, which will ultimately be passed on to the consumer.[66]

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62 Association of Financial Advisers, *Submission 66*, p. 11.

63 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Paragraph 2.26, pp 29–30.

64 Industry Super Network, *Submission 12*, p. 2; Industry Super Network, *Supplementary Submission 12*, p. 4.

65 Joint Accounting Bodies, *Supplementary Submission 23*, p. 3.

66 Joint Accounting Bodies, *Supplementary Submission 23*, pp 3–4.

5.61 JCG believed allowing a carve-out for life risk insurance commissions outside superannuation may exacerbate the 'mis-selling and churning' of life risk insurance 'especially as, after the commencement of the Bill, life risk insurance will be the product that is most likely to provide financial advisers with commission income'.[67]

5.62 Treasury told the committee that 'the risk of possible reductions in insurance advice is one of the main reasons why the government decided not to ban all insurance commissions'.[68]

Committee view

5.63 The committee believes that the bans on commissions for insurance inside superannuation provide important consumer protections.

5.64 The committee is mindful of the prediction that life-risk insurance will be the product most likely to provide advisers with commissions. It therefore recommends that ASIC conduct shadow shopping exercises post-implementation of the Bill to monitor whether conflicted advice is being provided on risk insurance outside superannuation.

Recommendation 7

5.65 The committee recommends that the Australian Securities and Investments Commission (ASIC) conduct shadow shopping exercises on advice pertaining to life risk insurance outside superannuation post implementation of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. ASIC should report its findings back to this committee within two years of the date the Bill commences.

Remuneration for group life insurance inside superannuation

5.66 Group life insurance is commonly understood as a structural arrangement where insurance is purchased from a life company by a trustee of a superannuation fund on behalf of a group or class of members to provide administrative and cost benefits for trustees and their members.[69]

5.67 A number of submitters argued that remuneration for the sale of group life policies within superannuation should be allowed on the basis that tailored advice is

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67 Joint Consumer Groups, *Supplementary Submission 25*, p. 8.

68 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 59.

69 Financial Planning Association, *Submission 62*, p. 20.

provided in these instances.[70] CSSA argued that group life insurance 'is not unadvised insurance, as has been suggested'.[71]

5.68 The table below compares the features of insurance inside and outside superannuation. It highlights that insurance offerings in superannuation provide administrative efficiencies for superannuation funds and allows members to access group premium rates. It also offers the flexibility of Successor Fund Transfers (SFT).

Table 6.1: Comparison of the features of insurance inside and outside super

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

Source: Financial Services Council, *Submission 58*, p. 57.

5.69 The Financial Planning Association (FPA) suggested that commissions on group life insurance should be allowed in the following instances:

70 ANZ Wealth, *Supplementary Submission 29*, pp 8–9; Corporate Superannuation Specialist Alliance, *Submission 30*, p. 3; Mr Brian Williams, iFinancial Solutions, *Submission 33*, pp 3–4; Moneywise Global Pty Ltd, *Submission 41*, p. 2; Matrix Planning Solutions, *Submission 42*, p. 5; FYG Planners Pty Ltd, *Submission 50*, p. 2; Financial Services Council, *Submission 58*, pp 54–55; Financial Planning Association, *Submission 62*, p. 20; Mr Robert Ross, *Submission 68*, p. 2.

71 Mr Gareth Hall, Treasurer, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 78.

- if a client actively seeks personal advice which results in the purchase of a group life insurance policy inside superannuation in order to access the advantage of the group life policy rate as an individual; and
- if a client seeks personal financial advice to review and top up their insurance needs where it relates to a group life insurance arrangement inside superannuation (the commission should only be payable on the increase of life insurance cover and not from all members of the group-life arrangement).[72]

5.70 Westpac agreed that 'group life policy' should be amended to only capture situations where the product provides a pre-determined level of cover to the client (without tailored advice) and suggested an additional amendment that:

> ...in order to obtain insurance cover, the member must make a separate application for coverage under the product, including choosing the benefits and levels of cover.[73]

5.71 CSSA suggested an alternative remuneration model should the proposed ban on group insurance within superannuation proceed. CSSA further proposed that when insurance services are provided to an employer group, that a fee can be charged to all members at an agreed percentage as negotiated with the client.[74] Without this agreement in place, the default fee should be set to zero, to protect against firms charging a default commission even when advice is not provided.[75]

Regulatory arbitrage

5.72 As well as highlighting that tailored advice can be provided for group life insurance inside superannuation, IOOF Holdings argued that the Bill creates distortions between advice that is provided inside and outside superannuation:

> We submit that it is inequitable to permit charging of commissions on individual life risk policies within super while disallowing it for group life risk policies, even though the clients in both instances have obtained advice in relation to their insurance requirements. Equally it is inequitable between clients within the superannuation and non superannuation environments where a financial adviser is managing clients' investments holistically. We would further submit that it should be acceptable for level commission to be payable to financial advisers on group life policies as this in fact eliminates perceived conflicts.[76]

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72 Financial Planning Association, *Submission 62*, pp 20–21.

73 Westpac Group, *Submission 64*, p. 32.

74 Corporate Superannuation Specialist Alliance, *Submission 30*, p. 3.

75 Mr Douglas Latto, President, Corporate Superannuation Specialist Alliance, *Committee Hansard*, 23 January 2012, p. 82.

76 IOOF Holdings Limited, *Submission 19*, p. 4.

5.73 The AFA also argued that the Bill will create two different playing fields:

> ...we are facing a world where there are two different playing fields. If you are an individual, you can get advice and the adviser can get paid a commission inside and outside super. You can do the same for large group plans outside super, but not inside super. So what you end up with is a playing field that really has different rules and, in our view, will distort the advice outcomes as consumers look for the best outcome and obviously work with the advisers that look after them. The simple way to think about it is to take the view that, where advice is provided, commissions are allowable whether they are inside super or outside super; where no advice is provided, clearly there should not be any payment. But to create an artificial piece around the way advice is provided makes no sense at all. In fact, for those advisers who are specialists in the small business superannuation environment, it is a significant threat to their future and to their business.[77]

5.74 The committee discussed the potential for regulatory arbitrage is relation to group life insurance with the Association of Superannuation Funds of Australia. It noted that 'wherever you have regulatory arbitrage it will drive behaviours'. Further:

> What those behaviours are I do not think we can foresee but certainly any regulatory arbitrage is, I think, always something to be avoided in any legislation and in any policy.[78]

5.75 In relation to risk insurance within superannuation, the Association commented:

> The issue that has been raised with us is this: the government's policy is very much when you receive individual advice about your individual cover and it is a stand-alone cover, so you are not part of an employer group, then commission should be able to be paid because you have got an engaged managed relationship with that adviser. Because of the nature of superannuation funds and because of the nature of the trust structure, the trustee buys the wholesale group policy. Where you have individual persons who are not part of employers but who are individuals putting their insurance under the fund because of tax purposes or efficiency purposes, they have individual cover, individual advice and are individually remunerated to the adviser. But because it is under a wholesale group policy they are still caught.[79]

5.76 Treasury outlined that the banning of commissions inside superannuation is consistent with the recommendation of the Super System Review (the Cooper

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77 Mr Richard Klipin, Chief Executive Officer, Association of Financial Advisers, *Committee Hansard*, 23 January 2012, p. 13.

78 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 24 January 2012, p. 13.

79 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Committee Hansard*, 24 January 2012, p. 13.

Review) as these commissions have the potential to affect the quality of advice. It also noted that ASIC shadow shopping surveys have indicated that in cases of poor advice, over half involved poor life insurance advice.[80]

5.77 Treasury informed the committee, however, that the government is still considering whether group life insurance should be treated in the same manner as individual risk insurance policies. Treasury commented that:

> It is not individually-advised versus group; it is individually-written policies versus group policies.
>
> The argument that has been put to government is that there is some individually-advised insurance within a group policy context and that that should be treated in the same way as individual policies.[81]

5.78 However, Treasury indicated that the government has yet to come to a conclusive view and the matter is still under discussion.[82]

Committee view

5.79 The committee does not accept a blanket statement that personal advice is provided to members on all group life insurance offerings. However, it does recognise that there are instances where tailored advice is provided on group life insurance and therefore it may be inequitable to allow for benefits to be paid on risk insurance outside superannuation. This may create market distortions and affect the quality of advice provided to consumers. One possible outcome, for example, is that it could deter advisers from offering group life insurance (which may have a discounted wholesale rate) over offering risk insurance outside superannuation where they will receive a commission. The committee considers this would be a poor outcome.

Recommendation 8

5.80 The committee recommends that post-implementation, Treasury work with the Australian Securities and Investments Commission (ASIC) to monitor closely the quality of advice on the sale of risk insurance inside and outside superannuation and any market distortions that may occur.

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80 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'How does the ban on conflicted remuneration apply to risk insurance?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

81 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p. 63.

82 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 63.

Asset-based fees on borrowed amounts

5.81 The Bill establishes a ban on asset-based fees (a fee calculated as a percentage of a client's funds under advice) on borrowed amounts.[83]

5.82 A 'borrowed amount' refers to an amount borrowed in any form, secured or unsecured. An exemption is provided if it is not reasonably apparent to the licensee or adviser that the monies used by a retail client are borrowed. The EM states that the test for 'whether something is "reasonably apparent" is an objective one, based on whether it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice, exercising care and assessing the client's information objectively'.[84] The Bill will establish such an offence, as subject to maximum civil penalties of $200,000 for an individual or $1,000,000 for a body corporate. Treasury commented that the rationale for the measure:

> ...is to prevent advisers from artificially inflating their advice fee by recommending a client borrow additional funds (inappropriate borrowing strategies were a key concern arising out of the collapse of Storm Financial).[85]

5.83 The FPA submitted that asset-based fees should not be considered conflicted remuneration where they act against a client's interest as it is a form of 'calculating' remuneration:

> ...to equate "asset based fees" with "conflicted remuneration" shows a profound (or potentially deliberate) misunderstanding of the fact that ‘asset based fees' are not a form of remuneration at all, but very simply a form of 'calculating' remuneration. When coupled with the professional expectations that require client directed payment and prohibit product or strategy bias that act against a client’s interest, it is clear that this form of calculation does not create conflict at all.
>
> The issue that should be debated is not which calculation model is permissible for borrowed amounts, but whether the remuneration in the financial planning profession is respondent to professional expectations of practice, transparency and comparability and more than anything else, aligned to professional expectations of a service that delivers value.[86]

5.84 The FPA suggested that the ban on asset-based fees on geared funds should be removed as it is 'disingenuous to the benefit that a statutory best interest duty obligation will provide' and that the best interest duty 'will assist in driving the

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83 Treasury, *Submission 22*, p. 9.

84 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, *Explanatory Memorandum*, p. 37.

85 Treasury, *Submission 22*, p. 9.

86 Financial Planning Association, *Submission 62*, p. 25.

behavioural change needed to address this issue'.[87] Burrell Stockbroking and Superannuation (BSS) also suggested that the 'best interest duty' is sufficient to protect consumers in relation to gearing:

> In order to manage risk, clients who use borrowed funds for investment purposes need a higher level of advice than clients who invest their own funds. We advise clients who borrow funds for investment to operate a low risk strategy, such as investing only in blue chip stocks. Removing the ability to charge asset-based fees on borrowed funds will diminish the level of advice provided to clients who borrow. It is essential that clients who borrow continue to access professional advice to manage their risk. The Bill should reconsider the ban on charging asset-based fees on borrowed funds.
>
> Placing a ban on asset-based fees on borrowed funds is not the way to stop over gearing, the like of which lead to the Storm Financial collapse. If an adviser has correctly and diligently obtained a client’s information and objectives, then appropriate advice would mean a client is not over geared... It is our opinion that the 'best interest duty' would be sufficient to ensure gearing is controlled.[88]

5.85 FPA suggested that the following circumstances should be explicitly excluded from the bans on asset-based fees:

- where the financial planner is not responsible for, and has not recommended, the client borrow to invest (the gearing). For example, the client already has geared funds and requests an investment strategy from the financial planner; and
- an existing client has a geared portfolio prior to the commencement of the Bill, and 'tops up' the gearing for further investment opportunities following the commencement of the Bill.[89]

5.86 Mr Russel Tym, a submitter to the inquiry, suggested that the measure will deter clients from using borrowing strategies as the ban will force advisers to move to alternate remuneration structures, and charge large initial fees to assist consumers to set up their savings plans.[90]

5.87 Treasury argued that the measure allows advisers to recommend a borrowing strategy if it is in a client's best interest and that advisers are able to use alternative remuneration methods in these instances:

> The measure does not prevent advisers from recommending borrowing strategies to clients, especially if such a strategy is in a client’s best interests. However, the adviser would need to find an alternative method to

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87 Financial Planning Association, *Submission 62*, pp 25–26.

88 Burrell Stockbroking and Superannuation, *Submission 11*, p. 7.

89 Financial Planning Association, *Submission 62*, p. 26.

90 Mr Russel Tym, *Submission 40*, p. 3.

> charge for advice on the borrowed component. For example, the adviser could charge an hourly rate or a flat fee which is not percentage-based.[91]

5.88 ISN supported the provision, and opposed the deduction of any form of asset-based or ongoing fees. It suggested that permitting them 'enables the industry to replicate all the ill-effects of commissions'.[92] The JCG agreed and suggested that the restrictions on asset-based fees should be widened,[93] particularly as the EM outlines that asset-based fees are likely to become more prevalent after implementation of the Bill.[94] The JCG also asserted that asset-based fees mimic the features of commission remuneration:

> Firstly, they create conflicts of interests or incentives that may encourage the adviser to give poor quality advice. They bias advice away from strategic advice, such as personal debt reduction, towards recommendations to acquire products from which an adviser can extract an asset-based fee. They do not provide an incentive to provide ongoing services to the client because the financial adviser is paid regardless of the services provided. Secondly, they are frequently not transparent to clients as they often involve the payment of fees out of funds under the control of the adviser, without any direct involvement by the client...Finally, asset-based fees bear no relationship to the work actually done by the financial adviser...
>
> These inherent flaws in asset-based fees often lead to excessive fees for financial advice. Research conducted by Rice Warner Actuaries in May 2011 indicates that the cost of advice provided by an adviser who uses a commission or asset-based fee remuneration model is 3 to 18 times the cost of similar advice provided by an adviser who uses a fee-for-service remuneration model. The higher fees paid by clients whose advisers use a commission or asset-based fee remuneration model will obviously erode the wealth of these clients.[95]

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91 Treasury, *Submission 22*, p. 9.

92 Industry Super Network, *Submission 12*, p. 2; see also Joint Accounting Bodies, *Supplementary Submission 23*, pp 5–6.

93 JCG requested that the Bill be amended to ensure that a licensee, or its representative, 'must not charge an asset-based fee for financial product advice if borrowed funds have been, are or will be used to acquire financial products by or on behalf of the client to which the financial product advice relates' and that asset-based fees be permissible only if all borrowed funds have been repaid at the time the fee is charged.
Joint Consumer Groups, *Supplementary Submission 25*, pp 10–11.

94 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 49.

95 Joint Consumer Groups, *Supplementary Submission 25*, pp 9–10.

Burden of proof that money is not borrowed

5.89 Westpac commented that the burden of proof under the 'reasonably apparent' that money is not borrowed test would be costly and onerous for both the product provider and the customer:[96]

> Given that many customers set up instructions when they first invest, and often make additional investments electronically (e.g. BPAY or direct debit), ascertaining each and every time if the investment is from borrowed funds is near impossible and very inefficient.[97]

5.90 Westpac suggested the inclusion of a specific exemption for product providers that are simply facilitating the payment of adviser fees through the product.[98]

Committee view

5.91 The committee notes that under the FOFA reforms, consumers can continue to use borrowing strategies where it is in their best interest: in this case, the adviser can charge a fee for service.

Grandfathering provisions

5.92 The Bill has provisions on the application of the ban on conflicted remuneration where benefits 'given under an arrangement entered into before the day on which that item commences' do not apply.[99] Minister Shorten announced in August 2011 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.
>
> This means that, in relation to trail commissions on individual products or accounts, any existing contract where the adviser has a right to receive a trail commission will continue after 1 July 2012, or in the case of certain risk insurance policies in superannuation, 1 July 2013.[100]

5.93 The grandfathering provision (or 'application of ban on conflicted remuneration' as stated in the Bill) is conditional on:

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96 Westpac Group, *Submission 64*, p. 29.

97 Westpac Group, *Submission 64*, p. 29.

98 Westpac Group, *Submission 64*, p. 30.

99 *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, s1528.

100 The Hon. Bill Shorten, MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms – Draft Legislation', *Media Release 127*, 29 August 2011.

a) The benefit is given under an arrangement entered into before the day on which that item commences; and

b) The benefit is not given by a platform operator.[101]

5.94 The AFA and the FSC argued, however, that what is proposed and what has been delivered are different.[102] The ABA argued the case for clear grandfathering provisions to be included in the Bill:

> Firstly, banks and other financial service providers have varying employment and workplace arrangements as well as contracts and service agreements. In the absence of clear grandfathering arrangements, it is uncertain whether the Government is able to intervene in these arrangements, contracts and agreements legally or whether banks and other financial service providers are able to cease or alter these arrangements unilaterally or within imposed timeframes. We note that some arrangements have years to run before they expire or are due to be renegotiated...
>
> Secondly, the issue of 'crystallisation' must be taken into account during the drafting of the grandfathering provisions. This issue was noted in Minister Shorten's announcement, which indicated that the ban on conflicted remuneration would prohibit future payments to, for example, licensees/representatives in respect of new investments through a platform but will grandfather payments to licensees/representatives in respect of investments in a platform accumulated prior to 1 July 2012. This means the level of volume payments from platform providers to dealer groups will 'crystallise' and result in the need for major reconfigurations to support crystallisation of overrides, such as trail commissions, as at the commencement date.[103]

5.95 The FSC noted that paragraph 1528(1)(b), which details the ban on conflicted remuneration, does not apply where 'the benefit is not given by a platform operator'. It argued that this 'amounts to a retrospective ban on conflicted remuneration paid by platforms' and 'is inconsistent with all previous policy announcements on this matter':

> 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.[104]

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101 *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, ss 1528(1).

102 Association of Financial Advisers, *Submission 66*, p. 12; Financial Services Council, *Submission 58*, pp 51–52.

103 Australian Bankers Association, *Submission 67*, p. 40.

104 Financial Services Council, *Submission 58*, p. 52.

5.96 Treasury commented that the FOFA reforms 'will have a substantial impact on industry and the grandfathering of existing contracts will mean that the changes will apply on a more gradual basis'.[105]

Committee comment

5.97 The committee has requested a response from Treasury as to why section 1528(1)(b) has been included where grandfathering is not given when 'the benefit is not given by a platform operator'. The committee asked Treasury to comment on this issue in light of arguments that this does not align with the government's policy intention. Although the committee had not received a response before finalising its report, it is important that Treasury does explain this issue on the public record.

Technical amendments and 'drafting anomalies'

5.98 The committee notes that a number of industry members raised concerns that the Bills contain drafting anomalies relating to conflicted remuneration issues and have recommended drafting amendments for the Bill.[106]

5.99 Mr Jim Murphy, Executive Director of the Markets Group of Treasury has highlighted the difficulties of providing industry with concrete certainty in regulatory material during major reforms:

> In relation to the views expressed here by industry yesterday—I know these people personally, I have worked with them for a long time, and I have a very high regard for the representatives of some of these industry organisations and for some of the major institutions—these are challenging reforms for industry, and industry of course, where they have businesses to run, will look for concrete certainty in legislation and explanatory material. I suggest to the committee that it is very difficult or probably not possible to give concrete certainty as to how things will work out in terms of legislation. What we have to do is to provide as much guidance and explanation as possible to the industry through the bill, the explanatory material and ASIC's explanatory notes.[107]

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105 Treasury, *Future of Financial Advice Frequently Asked Questions*, 'Why weren't commissions banned retrospectively?', http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm#Q3_2 (accessed 10 February 2012).

106 Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 5; Financial Services Council, *Submission 58*; Law Council of Australia, *Submission 62*; Westpac Group, *Submission 64*; Australian Bankers Association, *Submission and Supplementary Submission 67*.

107 *Committee Hansard*, 24 January 2012, p. 58.

Committee comment

5.100 In addition, the uncertainty of industry members in relation to conflicted remuneration was acknowledged by a Bills Digest released by the Parliamentary Library. The committee agrees with the commentary in the Bills Digest that ASIC has an important role to play in clarifying issues and allaying stakeholder concerns.[108]

5.101 The committee notes that the Bills represent major reform of the financial services sector and perhaps the most significant reforms in the last decade.[109] As with any major reform, there will be some uncertainty for stakeholders in the way in which legislation will be interpreted and how industry participants should apply the new laws. With this in mind, Treasury and ASIC should ensure that any uncertainty is addressed and further clarity be provided wherever possible.

108 Margaret Harrison-Smith, Parliamentary Library, 'Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011', Bills Digest No. 96, 2011-12, p. 11.

109 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 58.