FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: futureofadvice@treasury.gov.au

19th February 2014

Dear Sir / Madam

RE: Exposure Draft - FoFA Amendments

The Financial Planning Association of Australia (FPA) welcomes the opportunity to contribute to the Future of Financial Advice (FoFA) reforms. The proposed amendments are significant changes and we hope to engage in further consultation with Treasury and the Government on these changes in the coming weeks.

The FPA is broadly supportive of the Government's intent to improve FoFA by reducing unnecessary red tape and providing certainty for scaled advice, without exposing consumers to unnecessary risk. However, there are major risks and challenges in this endeavour. It would not be in the public interest if these proposed changes reversed the FoFA generated shift to 'fee-for-service' advice business models, or undermined the necessary evolution 'sales and distribution' to professional advice centred on the client ('client first').

Our general aim in this submission is to identify some flaws and risks in the proposed changes, and where possible suggest improvements in the drafting to reduce the risk of consumer detriment.

Thank you again for the opportunity to comment on the exposure draft of the FoFA amendments. If you have any questions, please contact me on 02 9220 4500 or dante.degori@fpa.asn.au.

Yours sincerely,

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia[1]

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[1] The Financial Planning Association (FPA) represents more than 10,000 members and affiliates of whom 7,500 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- We banned commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FoFA.
- We have an independent conduct review panel, Chaired by Professor Dimity Kingsford Smith, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

FOFA EXPOSURE DRAFT BILL

FPA SUBMISSION | THE TREASURY | DATE: 19.02.2014

Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

&

Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014

PROPOSED FOFA AMENDMENTS

FPA submission to:

The Treasury

19 February 2014

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ASSOCIATION *of* AUSTRALIA

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EXECUTIVE SUMMARY

This submission forms the latest of a series of considered contributions to the formulation of sensible FoFA regulation on behalf of the Australian public.

The Financial Planning Association of Australia (FPA) is committed wholeheartedly to the core principle of placing the client's best interest above all else.

It is enshrined in our Code of Professional Practice as a guiding beacon to those whose endeavor it is to enrich the lives of all Australians through the delivery of high quality, soundly regulated, professional financial advice.

FPA presents this submission in the context of nurturing a self-sustaining ecosystem of professional financial planners operating under an enforceable Code and accountable to the professional framework, including its Code of Ethics, Practice Standards and Rules of Professional Conduct.

Beyond that robust internal professional framework, FPA seeks to positively influence the regulatory oversight of our profession by drawing a clear line guided, once more, by what is in the best interest of consumers.

This submission draws that line on the detail of the proposed FoFA Amendments.

It makes constructive recommendations, specifically in relation to the key aspects of:

- **General Advice**: we do not support commissions via this proposed amendment
- **Scaled Advice**: we believe greater tightening is required for the appropriate delivery of scaled advice to avoid unintended consequences
- **Best Interests Duty**: we endorse the removal of sub-section s961B(2)(g)
- **Conflicted Remuneration**: We propose stronger consumer protection mechanisms by way of removal of unnecessary proposed Corporations Law amendments and clearer guidelines pertaining to the treatment of general advice exemptions, while banning conflicted remuneration for complex financial products
- **Opt In and Annual Fee Disclosure Statements**: We support repeal of Opt-in and support prospective Fee Disclosure Statements

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FOFA EXPOSURE DRAFT BILL

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INTRODUCTION

The FPA acknowledges that the Future of Financial Advice (FOFA) reforms have been guided by two overriding principles:

1. Financial advice must be in the client's best interests – distortions to remuneration, which misalign the best interests of the client and the adviser, should be minimised; and
2. In minimising these distortions, financial advice should not be put out of reach of those who would benefit from it.

The FPA's ultimate aim is to ensure that we protect both our profession and the clients who give us a profession. Unfortunately in a commercial environment, increased regulation and the associated costs are ultimately borne by the end consumer and for this reason it is important that we ensure unnecessary measures are amended or removed, so as to ensure financial planning advice is affordable and available to all Australians and not just the very wealthy. To this end, the FPA supports the introduction of effective regulation.

The FPA supports the proposed amendments and the policy intention of these amendments. However, our review of the exposure draft has identified some concerns. Specifically, we are concerned with the reintroduction of commissions for general advice, which will negatively influence outcomes for retail investors, as well as the perception of financial advice in Australia. The uniform position of Australian and international financial regulatory bodies is that general advice models place consumers at greater risk of making misinformed financial decisions, especially when compared with the outcomes from independent and objective personal advice.

In particular, the FPA is extremely wary of product distribution models which rely on general advice, as we believe these business models encourage a complementary 'sales model' of financial product issuance and distribution. As such, while we do not support the re-introduction of commissions we do understand the intention of this amendment. Therefore the FPA offers recommendations which mitigate the associated risks.

The FPA also agrees with the policy objectives behind facilitating scaled advice within the FoFA framework. Again, we are concerned that the proposed drafting of scaled advice will expose consumers to inappropriate products on the basis of a 'bests interests' safe harbour. Couching scaled advice in the language of personal responsibility and empowerment will not address the underlying risks associated with financial illiteracy and vulnerability. As such, we offer a workable solution that requires financial planners to consider the client's relevant circumstances, while providing specific disclosure of material factors which are outside of the scope of the advice.

Whilst the FoFA amendments are intended to be underpinned by the disclosure-based regulatory framework - an approach which is being rapidly superseded in Australian and international financial services regulation - effective balancing of these risks in the context of scaled advice requires a regulatory strategy that integrates disclosure, product regulation, and gatekeeper regulation if it is to meet

these significant challenges. We propose that the amendments, particularly those which are related to conflicted remuneration, are supported by research, investigation, and guidance by ASIC and Treasury as to future directions for the regulation of financial advice.

There are several aspects of the proposed amendments which the FPA supports, such as the removal of the opt-in requirement, as well as applying the FDS regime on a prospective basis. The FPA has never supported these provisions of FoFA, as we believe that their compliance is disproportionate to the limited consumer protection which these measures offer. FDS and opt-in are fundamentally about client engagement, which presents a real challenge for the culture of financial services in Australia that cannot be resolved solely through legislation.

We also welcome the removal of the ‘catch-all’ provision of the best interests duty (section 961B(2)(g) of the Corporations Act). This provision has caused much concern and confusion since its introduction in respect to the safe harbour steps. This amendment will help address concerns that the catch-all provision creates significant legal uncertainty, effectively awaiting for the courts to define what this step means, and renders the safe harbour unworkable for financial planners due to its open-ended nature.

Additionally, our view is that the financial planning profession should develop and adopt the standards and technologies required to understand the client and provide appropriate advice on that basis. While legislation and the judicial system should always offer a safety net for consumers, a culture of financial advice that emerges from an organic process of meeting the needs and objectives of clients offers the best prospect for real consumer protection and quality advice outcomes.

We urge Treasury to develop the necessary changes to support the underlying policy aim of raising the standard for financial advice in Australia.

THE BEST INTERESTS DUTY

The FPA supports a best interest duty that places the client's interest first. Placing the client's interests first is a hallmark of professionalism, requiring the financial planner to act honestly and not place personal or employer gain or advantage before the client's interests. The best interest duty should require financial planners to be motivated by, and give priority to, the interests of the client ahead of their own interests, and the competing duties to their employer and/or licensee, in the preparation and provision of financial advice to consumers.

To avoid the imposition of unnecessary cost and compliance burdens on professional advisers and professional advice businesses, as far as possible, this protection should be afforded legislative certainty rather than merely being left to regulatory guidance or the courts.

The FPA remains concerned that the formulation of the duty in Section 961B(2)(g) might be an encouragement to litigation or over zealous enforcement, given the history of statutory use and judicial interpretation of the term 'best interest'. It is our view, that 'best' in this context is not intended to be absolute or objective, but is always referable to the subjective circumstances in which a piece of financial advice is given and with reference to reasonableness. In the context of professional advisers giving professional advice our view is that the test is not intended to imply any higher duty at law than that of the reasonably diligent professional financial adviser acting competently. In providing this comment we reference the term 'professional' advisedly, since truly professional advice places the interests of the client ahead of any 'commercial' interest that might attach to the provision of the advice.

Nevertheless, the best interests of the client have been, and will always be, the fundamental criterion by which the advice of our members is judged. However, the catch-all provision of the best interests duty has created uncertainty, significant litigation risk, and an artificial approach to regulating financial advice culture in Australia. Indeed, the consumer protection offered by the catch-all is largely illusory, as it can only be realised through litigation.

The minimum standard which FoFA sought to enact cannot be mandated by legislation or originate from the judiciary. A confluence of hard and soft regulation, legislation and self-regulation, and innovation is required to interpret the standard for advice in various industries and be responsive to the needs of various consumers. This can only emerge with time, and by addressing other issues on the structure of financial advice in Australia.

Scaled advice

The FPA understands the intent of provisions 961B(2)(g) and 961E is to create a general regard to the client's 'best interest' in relation to the advice, in addition to the nominated steps in s.961B(2). The reasoning provided for the proposed removal of 961B(2)(g) and 961E is to facilitate the provision of scaled advice.

It is our assessment that the words in the legislation "taken any other step" (961B(2)(g)) and "take a step" (961E) create an open-ended requirement that is near impossible to meet in practice when providing personal advice to clients. To the extent that this proposed best interest amendment will eliminate the

untenable requirements created by the existing wording, the FPA in part supports the removal of 961B(2)(g) and 961E. However, the removal of these provisions has created some concerns in the best interest duty which, left unaddressed, may have significant implications for consumers

The FPA supports the removal of 961B(2)(g) and 961E along with additional changes to 961B to provide clarity for the provision of scaled advice while maintaining consumer protection and the intent of the best interest duty.

In so far as the best interests duty applies to the scale of advice, we do not consider the change to the first limb of subsection 961B(2) to be effective in facilitating scaled advice. As it would be unprofessional to rely on the order of the steps in the legislation to inform the procedure for financial advice, it is unclear how removing the reference to client instructions will facilitate scaled advice. If this amendment permits or encourages financial planners to collect information about the objectives, financial situation, and needs of the client outside or without reference to instructions from the client, we would oppose this change.

In the original legislation, scaled advice was organised in a minimalist but conceptually consistent system through sections 961B(2)(g) and 961E of the Corporations Act. The best interests duty required that financial planners and advisers would have to take extra steps to form a recommendation that is based on exercising care and objectivity in assessing the client's relevant circumstances, and then use those extra steps to consider the relevance of different products and strategies. Thus, even if substantive recommendations about these different products and strategies were not made, the financial planner or adviser was obliged to consider whether the scale of advice was suitable to the client.

However, this interpretation of scaled advice presumes a demand-oriented model. If firms offer scaled advice as a part of a sales model, then the financial incentive for financial advice relies on limiting the scope of that advice as far as possible. Business practices could emerge where financial advisers who are not bound by professional standards market themselves as financial planners but do little more than gather the legal minimum of information to make product recommendations. These business models may be highly skewed to prefer a few products or product types on the basis of that information. This is a very real concern, as ASIC has confirmed that complex products have been sold as part of financial advice within a limited scope.[2]

The FPA's Code of Professional Practice already addresses this problem by requiring FPA members to consider whether or not scaled advice would be in the best interests of the client before giving advice. Furthermore, they are bound by the Code to refuse to provide scaled advice if providing that advice would not be in the client's best interests. Financial planning professionals are held accountable by our Code for their decisions regarding scaled advice, and act as a gatekeeper that protects against potentially poor financial decisions.

[2] ASIC, *'Report 377 – Review of advice on retail structured products'* (December 2013), at [44]-[52]

While we believe that the FPA Code is intended to create professional standards that are above the minimum legal requirements, we still believe that retail investors must understand the choice which they are making when they act to limit the scope of the advice. Shifting responsibility for informational asymmetry to the client creates a moral hazard for all forms of financial advice, especially when combined with commissions-based business models.

To address this problem with scaled advice, we propose an obligation, contained in an amended note to section 961B(2), that the financial planner may only exclude those inquiries which are not reasonably relevant to the subject matter of the advice. We believe that this is consistent with the existing guidance on scaled advice through Regulatory Guides 175 and 244.

In the alternative, a new section of the Corporations Act could be implemented specifically to regulate the scale of advice. Again, consistently with Regulatory Guides 175 and 244, this section would legislate an obligation to *identify matters which are material to the advice but outside the agreed scope of the advice*. The financial planner must then warn the client that those matters have not been considered in the advice. We would expect a financial planner to identify those matters which a reasonable expert would identify when considering the client's relevant circumstances, the scope of the advice, and the needs, objectives, and financial situation of the client.

The FPA believes that our recommendations deliver on the policy intent while providing a balance between the need for efficient and affordable advice processes and maintaining the protection for consumers.

FPA Recommendation

To remove the existing untenable open-endedness and uncertainty of the existing legislation, the FPA recommends:

1. The removal of sub-section s961B(2)(g); and
2. The removal of section s961E.

However, the FPA recommends the government:

3. Do not proceed with the proposal to move subsection 961B2(a) to a new subsection 961B(2)(ba)

To ensure consumer protections and the intent of the best interest duty are maintained, while providing legal clarity, the FPA recommends the following additional amendments are necessary:

4. **Preferred option** – change the Note to s961B(2) to the following wording:

   Note: Nothing in s961B(2) is inconsistent with a provider limiting the subject matter of the advice where this is consistent with the client's relevant circumstances. To be clear, the adviser can exclude from their inquiry any client circumstances which are not reasonably relevant to the identified subject matter.

5. Alternative option – Strengthen the existing disclosure requirements for scaled advice, as detailed in RG175 and RG244, to ensure clients are fully informed at the commencement of the advice process of any matters that have a material impact on the scope of the advice. For example:

   a) require the adviser to identify matters which are material to the advice but outside of the scope of the advice. This process must be completed after having identified the objectives, needs, and financial situation of the client; and

   b) include a mandatory warning to clients that the scope of the advice does not contemplate particular matters which are material to the advice. The warning need not make a recommendation, but must give accurate disclosure of the context of the advice to allow the client to make an informed decision about the scope of the advice; and

   c) The warning must clearly explain the matters which materially impact the scope the advice.

CONFLICTED REMUNERATION

General advice

The draft legislation removes the ban of conflicted remuneration on general advice, potentially re-introducing commissions into the advice space, especially in superannuation. The FPA strongly opposes commissions and volume based payments from being permitted to be paid under general advice. The FPA does not support any return of commissions on investments (including upfront or trail commissions), especially in superannuation and we request that the Government resist any commissions-based model of general advice used to generate sales of financial products.

In an address to the South Australian Liberal Party luncheon on 31 January 2014 the Hon. Senator Arthur Sinodinos stated that:

> *"The Government remains committed to ensuring that commissions do not provide the basis for mischief and do not have a perverse effect on pricing that ultimately impacts the consumer and the provision of certain products in the market".*

It is undeniable that conflicted remuneration has eroded public confidence in our financial system. We note ASIC's contribution to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into financial products and services in Australia*;[3]

> *"Commission payments can create real and potential conflicts of interest for advisers. They could encourage advisers to sell products rather than give strategic advice (e.g. advice to the client that they should pay off their mortgage), even if the advice is in the best interests of the client and low-risk. Commissions also provide an incentive to recommend products that may be inappropriate but are linked to higher commissions."*

As stated above, commissions encourage advisers to sell products rather than give strategic advice. Australians do understand that the services which they use to ensure their financial security should not also be motivated to sell potentially inappropriate products in order to generate commissions and other forms of conflicted remuneration.

Allowing investment commissions and/or volume based payments to be paid on general advice have the potential to shift licensees and representatives away from the provision of personal advice in order to earn volume based sales commissions and would make 'personal' financial advice less available. In effect, this proposal would be likely to promote a new stream of 'general advice' licensee businesses and sales advisers incentivised by sales commissions.

Although the FOFA reforms were generally targeted at problems in the personal retail advice space, the FPA submits that maintaining the ban on investment commissions in relation to both general and

[3] At [168]

personal advice will eliminate the possibility of any advice (general or personal), incentivising advice providers to recommend a particular product. As general advice is most commonly provided by product manufacturer employed advisers (such as banks and super funds), arguably, general advice is more conflicted than personal advice, and it is advice for which there is no paper trail – i.e. There are no Statements of Advice or disclosure requirements when providing general advice.

The FPA has grave concerns that the draft regulatory impact statement has overstated the consumer benefit of providing general advice, and significantly understated the risk of misselling.

The draft regulatory impact statement contends, on the subject of exempting "general advice" from the definition of conflicted remuneration, that general advice is "less likely to influence a person's financial decision making" because it "does not take into account the personal circumstances of the client." We disagree with this analysis of general advice. It is in direct contradiction to ASIC's research and international best practice in regulation. For example, we draw your attention to ASIC's *Report 384 – Regulating Complex Products*, where the Report states;

> *"Our research has indicated that marketing information plays a particularly strong role in product distribution and may influence investors' decision making more than other product disclosure. In particular, when investors approach product issuers or other intermediaries responsible for selling products directly, rather than going through advisers, the information contained or implied in product issuers' marketing information is often the first, and may be the only, information that investors use to decide whether or not to invest in that product."*[4]

Furthermore, only one in five Australians receive personal financial advice, compared to the massive volume of general advice available to the retail investor. If general advice does not persuade individuals to a decision, then there would be little incentive or basis for paying employees and licensees through conflicted remuneration on general advice.

The exposure draft of the regulatory impact statement also states that;

> *"In addition, this amendment is likely to increase the prevalence of general advice as allowing commissions would facilitate its delivery. To the extent that general advice increases engagement and awareness of financial products, consumers may be better informed."*

This assertion is a gloss on the complex relationship between financial literacy, financial advice, and outcomes. It also conflicts with ASIC's stated position on the risks of general advice about complex products. In the past, ASIC has identified product distribution channels which rely on direct marketing or existing investors to sell complex products through general advice.[5] We again draw your attention to ASIC's *Report 384 – Regulating Complex Products*, where the Report states;[6]

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[4] ASIC, *'Report 384 – Regulating Complex Products* ' (January 2014), at [46]
[5] ASIC, '*Report 340 - 'Capital protected' and 'capital guaranteed' retail structured products*' (May 2013), at [52]-[54].
[6] ASIC, REP 384, above n 3 at [81]

> "Relative complexity is determined by considering complexity that has a personal negative impact on the investor (relevant complexity) in the context of how complex investors perceive the product to be. *Generally, the risk is greatest when investors perceive a particular product as simple when in fact it has a complex structure and/or features that may have an impact on its performance.*" [emphasis added]

Further, there could be difficulties in regulating a dual regime where commissions are permitted on general advice, but prohibited where personal advice is provided. This could create a loophole in the advice regime where it is possible to charge a notional amount for a personal advice component and recoup the remaining costs through commissions on general advice. It is also administratively and conceptually more streamlined to maintain the ban on commissions across the entire advice space, particularly because it is not always clear when general advice becomes personal advice - especially to the consumer.

Under the current definitions of personal advice and general advice it is very easy for financial planners and other AFSL representatives, such as call centre operators, to inadvertently overstep the mark into personal advice. However, regardless of the legal boundaries of personal and general advice definitions, it is the consumers' interpretation of the advice that ultimately determines whether they are being provided general product facts or information that relates to their own circumstances. Anecdotal evidence shows that it is common for individuals to interpret general advice as personal advice because it is relevant to their circumstances at the time it is provided. This is where incentives to sell products can mislead consumers.

The FPA recommends that the general advice exemption from conflicted remuneration should exclude commissions, including upfront and trail commissions. The extent of the exemption should be limited to employee salary bonuses and salary increases only.

To facilitate this legislative approach, the FPA recommends the government clearly define the term 'commissions' in relation to conflicted remuneration. In our Remuneration Policy, the FPA defines commissions as:

> *"An amount calculated as a percentage value of the consumer's asset or insurance premium payable by the product provider to the financial planner's licensee for recommending the product to the consumer. Commissions are not paid directly by the consumer but are paid by the product provider.*
>
> *A commission cannot be switched off and will be paid until such time as the client withdraws their funds or ceases life insurance cover."*

Despite our strong reservations regarding conflicted remuneration for general advice, if it must be exposed to conflicted remuneration then the government must act to regulate general advice to avoid perverse incentives which generate sales-oriented corporate cultures. As such, we offer recommendations which may mitigate the significant risks of these amendments.

FPA Recommendations

To strengthen consumer protection, the FPA recommends:

1. The proposed changes to section 963A of the Corporations Act should be removed.

If general advice is to be exempt from the definition of conflicted remuneration, the FPA recommends:

2. the following be explicitly excluded from the general advice conflicted remuneration exemption in the legislation:

   a) conflicted remuneration on general advice on superannuation be banned (similar to the ban on conflicted remuneration in the MySuper legislation for example);

   b) conflicted remuneration on general advice on complex products be banned;

   c) where the employee benefits for general advice are conflicted remuneration, such benefits do not exceed a threshold limit of the total employee remuneration package. For example, the conflicted remuneration does not exceed 10% of the total employee remuneration.

3. Clearly define commissions as a type of banned conflicted remuneration on general and personal advice.

4. Introduce a ban on conflicted remuneration in relation to complex products, except where personal advice has been issued in connection with the product and the recommendation includes an assessment of the client's understanding of the product.

5. Where the client does not understand a complex product, the financial planner or adviser should be prohibited from implementing the advice for that client, as far as it relates to the relevant complex product(s).

Execution-only services

It is important to appropriately understand the difference between general advice versus execution-only services. The FPA believes execution-only services are transactions to facilitate the sale of a product to a consumer. Such services do not come with the provision of any advice, general or personal, and are therefore generally driven by request from the consumer.

General advice refers to financial product advice where that advice does not consider the personal circumstances of the consumer. However, the provision of general advice and execution-only services are commonly inter-twined when such services are provided to consumers. As general advice frequently influences the consumer, the legislative approach to conflicted remuneration must address the consumer risks created by the link between the provision of general advice and execution-only service.

Where conflicted remuneration influences personal or general advice, the FPA opposes it. However, there may be some benefit to conflicted remuneration in the case of execution-only services, where no general or personal advice has been provided, so long as those benefits are not linked to sales volume. As such, we would not object to the model proposed in the Coalition's Dissenting Report to the Parliamentary Joint Committee on Corporations and Financial Services;[7]

> *"That section 963B(1)(c) be amended to link the payment for advice provided to a specific advice provider (rather than to any representative of a licensee) and to apply only where there is a causal link between past advice and current advice." [emphasis added]*

However, the amendments currently dispense with the causal link between past advice and current advice except in the case where personal advice has been provided in the past 12 months. As a result, consumers are exposed to a systemic risk of mis-selling through general advice models which are designed to generate leads for execution-only services. There is no consumer benefit to permitting these kinds of business practices out-side of the most basic financial products.

In addition to the risk of mis-selling, at no stage do the amendments specify any obligation to inform the client of any commissions attached to the product except through product disclosure. This is extremely problematic, given the difficulties with Australia's disclosure-based regime at present. As a risk mitigation strategy, relying on product disclosure will not change the fact that general advice models benefit from the reputational capital of professional financial planners. This is a significant market failure which prevents many investors from understanding the nature of the advice, as well as their legal relationship with the financial planner, adviser, or employee who provides the advice.

Despite the view in the draft regulatory impact statement that consumers are unlikely to be affected by this change, permitting conflicted remuneration for execution-only advice even where that advice is connected to prior general advice may have a material impact on consumers.

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[7] Parliamentary Joint Committee on Corporations and Financial Services, *'Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (February 2012)'*, at p 176

While our members are prevented by the FPA's Code of Professional Practice from obtaining such benefits, we do recognise the legitimacy of other business models which generate positive outcomes for consumers. If there is a benefit to be gained from incentivising execution-only advice through conflicted remuneration, it should be secured without reference to the volume of sales generated from associated entities.

We therefore recommend the following proposals, which include a general structure to permit conflicted remuneration for execution-only advice without a perverse incentive to increase the volume of sales at the expense of the client.

FPA Recommendations:

The FPA recommends the government:

1. retain the existing provision under s963B(1)(c):

   (c) each of the following is satisfied:

   (i) the benefit is given to the licensee or representative in relation to the issue or sale of a financial product to a person;

   (ii) financial product advice in relation to the product, or products of that class, has not been given to the person as a retail client by the licensee or representative in the 12 months immediately before the benefit is given;

2. do not implement provision 963B(3) and (4) as proposed in the draft legislation.

However, if it is deemed permissible for conflicted remuneration in relation to execution-only services where general advice also provided, consumer protections should be implemented to close institutional loopholes which create incentives for dishonest, inefficient, and/or unfair conduct. The FPA recommends:

3. Where a retail client acquires a financial product as a result of an execution-only service, all conflicted remuneration with respect to that sale should be banned if:
   a) general advice caused execution-only services to be provided; and
   b) the individuals or organisations who provided the general and execution-only service are related parties.

4. Where an authorised representative, an AFS licensee, or an employee of either, provide general advice regarding a product or class of products, and the provider has access to the consumer's personal details, the licensee must:
   a) provide written confirmation of the nature of the advice offered to that client, including a general description of the subject of the advice; or
   b) create and store phone records and other correspondence between the client and adviser/employee regarding that advice.

Balanced scorecard

While volume-based payments were permitted under the original FoFA legislation,[8] the exception was tempered by a rebuttable presumption that volume-based payments are conflicted remuneration. Rule 7.7A.12EB is intended to create a safe harbour for rebutting the presumption in section 963L. As safe harbours are inherently prone to the risk of creative compliance, we have reservations in implementing a safe harbour in this case on a risk/benefit analysis.

Furthermore, if the broad principle behind a rebuttable presumption is to allow volume-based payments which do not influence the advice, then we disagree with the specific criteria used in the proposed Rule. Providing that the benefit must be low in comparison to the employee's total remuneration, and outweighed or balanced by other matters, is no guarantee that the volume-based payments will not influence the advice.

Lastly, we also consider Rule 7.7A.12EB(2)(f) to be at least as ambiguous as the catch-all provision of the best interests duty. If the policy intent is to align volume-based benefits with providing advice in the best interests of the client, then the wording of section 963L and section 963C of the Corporations Act is sufficient to achieve that end.

The FPA does not support the reintroduction of conflicted remuneration for personal advice where that benefit may influence the advice. Our Code of Professional Conduct will continue to distinguish our members from financial institutions and advisers who accept conflicted remuneration as part of their business model. We encourage the government to limit its amendments to reducing the compliance burden on financial advice, and allow time for the ban on conflicted remuneration to positively change the perception of financial advice in Australia.

FPA Recommendation

If any safe harbour is adopted with regards to volume-based fees for personal advice, it should be based broadly on the principles and criteria contained in *Regulatory Guide 246: Conflicted Remuneration*, which established unambiguous circumstances where the presumption in favour of conflicted remuneration could be rebutted.[9]

[8] Corporations Act 2001 (Cth), s 963L
[9] ASIC, RG 246, above n 2

OPT-IN & ANNUAL FEE DISCLOUSRE STATEMENTS

The FPA welcomes the proposed amendments to repeal Opt-In and remove the retrospective Annual Fee Disclosure Statements.

Our view is that the opt-in regime would never have improved outcomes for consumers. It was structured in such a way that trailing commissions – which were ostensibly the target of the opt-in regime – would not have been covered by the law. Client engagement, as the other policy objective of opt-in is something that has to emerge organically from the profession. Financial planners who are members of a professional association should embody values of client engagement as part of their value proposition.

The FPA supports prospective FDSs as an effective way to track and understand the relationship that a client has with their adviser. In particular, they are part of the groundwork required to encourage clients to form a stronger relationship with their financial planner. By limiting FDS requirements to clients going forward, the amendments offer a more efficient and effective transition to FoFA. However, some of the information which licensees require to create an FDS is sometimes stored with a third party. To the extent that this information may take time to acquire and integrate into the FDS, licensees should be offered flexibility regarding the 30 day rule.

Many licensees and financial planners offer multiple products and platforms on their APL. In addition, advice fees are often charged through the product (under the direction of the client) such as an asset based fee model used by financial planners and licensees when providing advice to clients under an ongoing fee arrangement. An asset based fee charging model requires sourcing detailed data on each client's portfolio from relevant third parties (eg. Platforms, product providers) to determine the value of the asset over a set period of time and, therefore, the fee payable for the services received for the previous charging period (eg. Month or quarter). The creation of this data by the third parties is time consuming and can often create delays between the end of the charging period and the provision of the relevant data to the financial planner / licensee. This is out of the control of the planner and licensee.

Financial planners and licensees must receive this third party data to be able to provide the required information to the client in the FDS. This is a significant issue for financial planners in meeting the 30 day disclosure period for the provision of the FDS to the client, particularly those financial planners who are not part of a vertically integrated business.

Further, the FPA requests that treasury provide confirmation on the application of the fee disclosure statement. Specifically the FPA is seeking clarification on the purchase of a financial planning business (with pre-1 July 2013 arrangements) and whether this would trigger a 'new' arrangement.

FPA Recommendation:

Section 962G(1) creates the 30 day disclosure period for the FDS. S962G(2) states that *The regulations may provide that subsection (1) does not apply in a particular situation.*

Therefore, the FPA recommends amending the Corporations Regulations to include the following (or similar) regulation:

- *In situations where it is not possible to provide the fee disclosure statement to the client within the required 30 day period as required in s962G, due to reasons outside of the control of the licensee or its representative, the FDS must be provided to the client as soon as possible after the disclosure day.*

Or

- *In situations where it is not possible to provide the fee disclosure statement to the client within the required 30 day period as required in s962G, due to reasons outside of the control of the licensee or its representative, the FDS must be provided to the client referencing information that is available to the fee recipient, including if required, an estimate of the fee paid by the client.*

ASIC guidance would be required to clarify situations where meeting the 30 day requirement is outside the control of the licensee or representative, such as when the data is created and owned by a third party.

Other FoFA Amendments

Proposed Amendments or Clarification	FPA Comments
Intra-Fund Advice The Government has committed to clarifying the treatment of advice provided within superannuation by clarifying the term intra-fund advice in the FOFA legislation. A proposed note clarifies the link between the term 'intra-fund advice' and the relevant subject rules under section 99F of the SIS Act. This note will be added at the end of section 960.	The FPA supports that clarification that this amendment brings to the FoFA legislation. Intra-Fund advice is a form of financial product advice along side personal advice and general advice. The note confirms the definition and prohibition of passing on costs to members of the fund as legislated in the SIS Act section 99F and 99F(1)(c) respectively.
Client-pays exemption The existing exemption remains but is clarified that the benefit must be given at the direction of the client with the client's clear consent. Under the new law, a note will be inserted under section 963A to clarify the operation of section 52 in relation to the ban on conflicted remuneration. *[Schedule 1, item 26, section 963A (note)]*	The FPA welcomes this clarification point in ensuring that client directed fee-for-service arrangements are not captured as a conflicted remuneration.
Exemption for Life Insurance benefits Under the new law, the exemption provided for monetary benefits paid in relation to life risk insurance policies offered inside superannuation will be broadened such that the ban on conflicted remuneration will only apply in relation to monetary benefits paid with respect to: • life risk insurance products for MySuper members; and • life risk insurance products offered inside other (non-MySuper) superannuation products in circumstances where no personal financial advice has been provided to the member regarding life risk insurance. *[Schedule 1, item 29, paragraph 963B(1)(b)]*	The FPA welcomes this amendment in the legislation and supports a consistent remuneration structure between insurance inside super and outside super and does not support a model that would crate possible arbitrage as well as confusion for consumers.
Education and training exemption The education and training exemption will now apply if it is relevant to the operation of a financial services business, which includes the provision of financial product advice.	The FPA supports this amendment and clarification point regarding the training and education exemption.
Grandfathering – switching from accumulation to pension phase in super	The FPA welcomes and supports this clarification.

Subregulation 7.7A.16B(5A) will be inserted to provide that when a retail client elects to switch from the growth phase to the pension phase within the same superannuation interest, this will not be treated as the acquisition of a new financial product for the purposes of regulation 7.7A.16B. This will allow grandfathered benefits to continue to accrue where the client held the superannuation interests prior to 1 July 2014 and made the election after this date.	
Grandfathering arrangements – buying and selling as well as moving between licensees Subregulation 7.7A.16A(5A) will be inserted into the regulations to clarify that when a business is sold (and that business is acting in the capacity of a platform operator), the rights to the grandfathered benefits are transferred to the purchaser, who can then receive the ongoing benefit. The purchaser may therefore acquire the same rights to the grandfathered benefits that the seller held prior to the sale taking place. Subregulation 7.7A.16B(4A) which has the same effect as 7.7A.16A(5A) except that this subregulation refers to the sale of businesses which are not acting in the capacity of a platform operator. Items 22 and 23 – amend existing regulation 7.7A.16F to provide that the requirement in paragraph 7.7A.16F(b) does not apply when: • an authorised representative of one licensee becomes an authorised representative of another licensee after the application day of the ban on conflicted remuneration; • a representative (for example, an employee) of a financial services licensee becomes an authorised representative of the same licensee.	The FPA supports the proposed amendments to the Grandfathering Regulations. The current grandfathering regulations impacts on the fairness and equity of buying and selling of a financial planning business, and a financial planner ability to change licensees.