Submission to the Parliamentary Joint Committee on Corporations and Financial Services

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

10 January 2012

Contents

Executive Summary

The Westpac Group, which includes BT Financial Group (BTFG), welcomes the opportunity to provide comments on the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (the Bills).

The Westpac Group would like to thank and acknowledge the previous work of the Parliamentary Joint Committee on Corporations and Financial Services (the Committee) through its inquiry into financial products and services, which subsequently led to the Government's Future of Financial Advice reform package (FOFA). The high profile cases of Storm, Timbercorp and Great Southern have caused significant damage to the livelihoods of many Australians, and in doing so damaged the reputation of the financial services sector and its many constituents.

We support the Government's overarching policy intent

The Westpac Group and BTFG support the Committee's views and the Government's policy intent with respect to financial advice. A robust financial services sector which avoids or manages practices and payments which can cause conflicts between financial advisers and their customers is important. Our super and investment system must be credible and trustworthy, with customers' interests at its heart - especially given Australia's superannuation savings pool is set for extraordinary growth. Improving the quality of advice, better transparency and increasing investor confidence in the industry are critical.

We have concerns with the practical implementation

Although the Westpac Group and BTFG support the intent of the Bills, we have identified a significant number of issues with the current draft legislation (some 44 issues in all) which could generate outcomes that will not achieve the Government's stated policy intent, or will result in impractical and costly implementation issues.

The following is a summary of our key concerns for each aspect of the FOFA Bills.

1. Opt-in and annual fee disclosure
    - The scope of the opt-in regime is broader than the announced policy
    - The retrospectivity of the fee disclosure statement requirements is inconsistent with announced policy
    - The detailed content requirements of the fee disclosure statement will cause undue administrative burden
    - The payment by instalment exemption is too narrow
    - The insurance premium carve-out has unintended consequences
    - Inconsistent use of the terms "give" and "send"
    - The non-renewal of an ongoing fee arrangement or voluntary termination requires a notice period
    - The civil penalty provision has no consideration of materiality
2. ASIC powers
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3. Best Interests Duty
    - The best interests duty as currently drafted will create uncertainty and increase the cost of advice

- The best interests duty is broad and undefined
- The best interests duty is inconsistent with existing general law fiduciary obligations

4. Scaled advice
    - The best interests duty as currently drafted does not enable affordable scaled advice
    - The application of the best interest duty to the scoping of the advice will increase the cost of scaled advice
    - To enable scaled advice the adviser and client need to be able to agree on the scope of the advice
    - Providing scaled advice through a computer program is not possible under the current drafting
    - The appropriate advice requirement must be judged according to the client's relevant circumstances and the agreed scope of advice
    - The requirement to ensure information is complete and accurate is too broad
5. Conflicted remuneration ban
    - The conflicted remuneration ban captures commercial business arrangements
    - Platform payments which are product neutral are captured in the ban
    - The execution only exception cannot be used by large financial services institutions
    - Client-directed fee for service payments through a product are captured in the ban
6. Conflicted remuneration ban – impact on employee remuneration
    - The conflicted remuneration ban will reduce consumer access to general advice
7. Volume-based shelf space fees
    - The shelf space ban is broader than the policy intent
    - A platform operator will not know the scale efficiencies gained by the funds manager
8. Soft dollar benefits
    - The current drafting can prohibit licensees and representatives from obtaining benefits that they pay for
    - Legitimate and valuable educational services will be banned
    - The IT software exemption is not equitable across the industry, and will not encourage the best software to be used
9. Ban on asset-based fees on borrowed amounts
    - The ban on asset-based fees on borrowed amounts captures some product issuer fees
    - Product providers who are only facilitating the payment of adviser fees through the product may not know if the amount is borrowed
10. Insurance
    - Superannuation platforms which achieve scale efficiencies on individual insurance policies are disadvantaged
11. Transitional provisions
    - The transitional provisions are ambiguous and do not allow grandfathering of existing commissions paid by platform operators

The Westpac Group would be happy to provide a more detailed analysis of the Bill and suggested drafting of legislative amendments if required.

An appropriate transition period is needed

At the outset of this letter we underlined the fact that we are supportive of positive change for our industry. However to ensure proper implementation an extension to the transition period for FOFA, or a delayed start date, is necessary in order to manage capacity and resource constraints.

Both the FOFA and Stronger Super Reforms will drive significant structural change across the industry – at significant cost, and with significant operational risk. Complying with the reforms and adapting technology and service infrastructure will be complex and take time to ensure robust and tested processes are in place for all customers.

The volume and complexity of change required within the next two years will carry significant operational risk. Complying with these regulatory changes alone will cost our business close to $70m over the next two years.

A large amount of uncertainty still exists with the FOFA reforms and many of the changes businesses will need to make to implement the reforms cannot commence until the legislation is passed and the industry has certainty. Given the FOFA reforms are due to start on 1 July 2012, and they are unlikely to pass into law until at least March 2012, we request the Government consider either extending the proposed start date or permitting a transitional period to 1 July 2013 to give the industry and advisers sufficient time to make the necessary changes to efficiently comply with this legislation.

Please do not hesitate to contact Alyson Clarke on (02) 8253 1702 if you have any questions, or would like to discuss this submission further.

Yours sincerely

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1. Opt-in and annual fee disclosure regime

BTFG strongly supports the principle that customers should only pay for the services they agree to receive and that are performed. However the introduction of a two-year opt-in regime needs to be simple and easy for customers, not an administrative burden or barrier to seeking good quality financial advice.

Our review of the Bill has identified several areas for which the Bill will generate an outcome that will not achieve the Government's stated policy intent, or will impose a significant administrative burden.

1.1 The scope of the opt-in is broader than the announced policy

As raised in BTFG's submission to Treasury on the Exposure Draft dated 16 September 2011, the scope of the opt-in provisions in the Bill is inconsistent with the Government's announced policy.

The Government announced on 28 April 2011 that the opt-in provisions would only apply to the "provision of personal advice to retail clients."[1] However the definition of an ongoing fee arrangement in the Bill (section 962A) has not been limited to personal advice. The result is that the drafting expands the scope to include other services such as execution services, reporting and administration services, and potentially ongoing product fees paid by the client. Practically this could mean that the client must also opt-in to ongoing product fees every two years, or ongoing administration services such as transaction processing, product change notifications, corporate actions notification and portfolio reporting – which would lead to adverse consequences for all parties.

Paragraph 1.16 of the Explanatory Memorandum also states that "the types of ongoing fee arrangements intended to be captured are those ongoing fees that are being charged for personal financial advice (including where the client is not actually receiving ongoing advice but still paying a fee to an adviser). The ongoing payment of an insurance premium or a product fee is therefore not intended to be captured as an ongoing fee arrangement."[2]

<u>Recommendation</u>:

The opt-in requirements should only apply to ongoing fee arrangements in respect of personal advice. The legislation needs to be amended to clarify this position.

1.2 The retrospectivity of the fee disclosure statement is inconsistent with announced policy

The Government announced in April 2011 that the opt-in requirement would apply prospectively and that a disclosure notice would need to be sent in the place of the opt-in notice "every second year where no opt-in renewal is required".[3] The implication of the Government's policy announcement is that the fee disclosure statement would apply prospectively, and this position was confirmed in the Exposure Draft of the Bill released by Treasury for consultation on 29 August 2011. Subsequently the final Bill entered parliament requiring the fee disclosure statement to be sent annually to all clients – that is to new and existing clients.

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[1] Future of Financial Advice Information Pack 28 April 2011, Section 3.
[2] Corporations Amendment (Future of Financial Advice) Bill 2011 - Explanatory Memorandum paragraph 1.16, page 8.
[3] Future of Financial Advice Information Pack 28 April 2011, Section 2.2.

Whilst the Bill differs from the announced policy, we support improving transparency and agree that all clients should have visibility as to the fees they pay and the services they receive. However the retrospectivity of the fee disclosure statement in the Bill gives rise to some practical implementation issues which have not been subject to consultation between industry and government:

- The Bill requires a fee disclosure statement be sent to all existing customers within 30 days of the "disclosure date". For existing customers as at 1 July 2012 the "disclosure date" will be "the anniversary of the day on which the arrangement was entered into". The original date of the arrangement may not be easily identifiable for every customer, and for some very long term customers may not be identifiable at all.

- The significant volume of existing customers can run into the hundreds of thousands for some advice businesses (dealer groups). As such, sending a fee disclosure statement to existing customers would need to be staggered over a period of time to allow an adviser's business to properly comply with the administrative requirements and respond appropriately to the volume of customer inquiries.

- A considerable amount of work will be required across the industry by dealer groups, advisers and product providers to capture and build the information necessary for the efficient administration of the fee disclosure statement. The work will be amplified if the fee disclosure statement is required for existing clients. Electronic feeds from all products in the market would be required – some of which may be old and closed to new investors, or administered on legacy systems.

Recommendation:

The Government should consult on the retrospective application of the fee disclosure statement to determine a path forward, and if necessary an appropriate transition period.

1.3 The detailed content of the fee disclosure statement will cause undue administrative burden

As raised in BTFG's submission to Treasury on the Exposure Draft, the Bill requires the fee disclosure statement to contain details of the services provided. The level of specificity and depth of the disclosure required will be extremely time consuming and require significant investment in Customer Relationship Management systems to track and report back the services provided to customers.

The customer and the adviser should be able to agree on the services provided and the regular level of reporting required on these services. Complying with the detailed disclosure requirements as drafted in the Bill will impose a significant time and cost burden, which will ultimately be passed onto customers. Alternatively, some services may be removed because they are too expensive to track and report on in detail.

For example the level of detail required by the Bill could mean itemising every phone call to and from the customer, itemising every email and piece of correspondence sent, even itemising every interaction with the product provider for which the customer has investments such as following up to ensure a transaction has been appropriately actioned.

Recommendation:

The legislation should not prescribe the form and detail of the notification. The customer and the adviser should be able to agree on the services provided and the regular level of reporting required on these services, and the client should be the one to determine whether or not they have received value.

1.4 Payment by instalment exemption is too narrow

BTFG understands that the Government's policy intent is to allow for a carve-out from the opt-in provisions where one-off advice is being paid for by instalments or a payment plan over a period of time. As such, the carve-out in section 962A(3) is too narrow, and does not work as intended because it requires the advice to have been provided before the arrangement is entered into. In the case of one-off advice, it is standard practice (and a better customer experience) for the fee arrangement to be agreed to before the one-off advice has been provided.

Amending the legislation to apply to personal advice given before the first payment instalment is made would achieve the Government's policy intent without creating any unintended consequences.

Recommendation:

Amend section 962A(3)(d) such that it applies to personal advice given to the person before the first payment by instalment is made.

1.5 Insurance premium carve-out has unintended consequences

BTFG understands that the Government's policy intent is to carve-out insurance premiums from the opt-in provisions. However the drafting of section 962A(4) in the Bill could be interpreted to mean that the exemption does not apply if the insurance premium is not the only fee payable under the ongoing fee arrangement.

Where a licensee or representative provides insurance advice as well as (for example) ongoing investment advice and both services are agreed to under the one arrangement with the customer, section 962A(4) could be interpreted to mean that the exemption does not apply as the insurance premium is not the only fee payable under the arrangement. The inability to use the exemption may also have the unintended consequence of encouraging advisers to limit their services to insurance advice, so as to fall outside the opt-in regime.

The outcome outlined above seems to be unintended and paragraph 1.16 of the Explanatory Memorandum supports this view stating that "the types of ongoing fee arrangements intended to be captured are those ongoing fees that are being charged for personal financial advice (including where the client is not actually receiving ongoing advice but still paying a fee to the adviser). The ongoing payment of an insurance premium or product fee is therefore not intended to be captured as an ongoing fee arrangement."[4]

[4] Corporations Amendment (Future of Financial Advice) Bill 2011 - Explanatory Memorandum paragraph 1.16, page 8.

Recommendation:

Section 962A(4) needs to be amended to clarify than an insurance premium is not a “fee” for the purposes of the definition of an ongoing fee arrangement, and that accordingly an arrangement to pay an insurance premium is not an ongoing fee arrangement, whether a stand-alone arrangement or included as part of an ongoing fee arrangement.

Furthermore, BTFG understands that the intention of the insurance carve-out in section 962A(4) is to carve-out the insurance premium (which may include a commission payment from the insurer to an adviser) from the definition of an “ongoing fee arrangement”. The current drafting is not specific with regard to the commission payment by the insurer, which is paid from the premium pool. Clarification in Explanatory Memorandum or Regulations is needed to ensure that the exemption also applies to commissions which are permitted to be paid by insurers.

From the start the Government has acknowledged that insurance needs to be treated differently. The Government announced that “by 1 July 2013 the industry will be required to unbundle disclosure so the dollar and percentage value of commissions are disclosed for all new and renewed policies”.[5] The Government’s policy will enable customers to see the impact of commissions on their premiums and address any concerns with regards to transparency. Given the complexity with how insurers fund and pay commissions to advisers for insurance, we believe that time is needed for the industry and government to consult on the practical implementation.

Recommendation:

The Explanatory Memorandum or Regulations need to clarify that the carve-out also applies to commissions which are paid by insurers, as per the Government’s policy intent.

1.6 Inconsistent use of the terms “give” and “send”

The Bill inconsistently uses the terms “give” and “send” with regard to the fee disclosure statement and renewal notice. The term “give” is more appropriate in both circumstances, given that the fee disclosure statement and renewal documents may be provided by the adviser to their client in face-to-face meetings.

In addition, the fee recipient (the adviser) should be able to discharge their obligation by sending the statement or notice to the last known address for the client.

To address both of issues, the term “give” as already defined in section 940C should be extended to apply to section 962G and section 962K.

Recommendation:

The terminology needs to be made consistent and aligned with section 940C. The use of the term “give” defined in section 940C should be extended to apply to section 962G and section 962K.

[5] Press Release – “Future of Financial Advice Reforms – Draft Legislation”, Assistant Treasurer and Minister for Financial Services and Superannuation, 29 August 2011.

1.7 The non-renewal of an ongoing fee arrangement or voluntary termination requires a notice period

If a client provides a notification to the fee recipient (adviser) during the renewal period that they do not wish to renew the arrangement, the arrangement terminates on the day on which notice is given (section 962M). A client also has the right to voluntarily terminate an ongoing fee arrangement at any time (section 962E).

However the adviser will need some period of notice to arrange the practical aspects of terminating the arrangement (e.g. notifying product providers to terminate payments).

In both situations outlined above, a minimum 30 day notice period for termination will give the adviser sufficient time to terminate the arrangement and ensure payments have ceased.

Recommendation:
Sections 962E and 962M should be amended to provide a minimum notice period of 30 days.

1.8 Civil penalty provision has no consideration of materiality

The civil penalty provision in section 1317G(1E) does not consider the materiality of the breach unlike comparative provisions, such as subsection 1317G(1A).

For a body corporate (e.g. a licensee or corporate authorised representative) to face a civil penalty provision of $250,000 or $1 million for any contravention of the opt-in civil penalty provisions or the anti-avoidance provisions retrospectively, is inappropriate. Instead, an additional requirement that the contravention be serious or significant in some way (e.g. material detriment to the recipient of the advice) should be provided.

Recommendation:
A materiality threshold comparable with subsection 1317G(1A) be introduced in respect of subsections 1317G(1E) to ensure that tests of material prejudice and seriousness apply.

2. ASIC powers

The Bill gives ASIC a significantly expanded power to give, vary or suspend an existing Australian Financial Services Licence (AFSL) if ASIC believes the AFSL holder is “likely” to contravene a financial services law or the other obligations imposed under section 912A at some point.

2.1 The ASIC powers should include objective criteria

The Bill should be amended to include some objective criteria that ASIC would need to take into account when exercising its discretion to give, cancel, vary or suspend an AFSL such as:

- the number of previous similar contraventions
- the likelihood of a contravention remaining unrectified
- the extent to which the likely contravention indicates the licensee or individual will not comply with their obligations in general

Recommendation:

The Bill should be amended to require ASIC to consider objective criteria such as those outlined above.

3. Best Interests Duty

BTFG supports the Government's intent to introduce a best interests duty requiring financial advisers "to act in the best interests of their clients and place the interests of their clients ahead of their own when providing personal advice to retail clients."[6]

A clearly defined best interests duty will simultaneously improve the quality of advice and increase consumer trust and confidence in the planning industry without raising the cost of providing advice. However the current drafting of the best interest duty will create uncertainty and increased the cost of advice. That is, the current drafting of the best interests duty is not in line with the Government's stated policy intent.

3.1 The best interests duty is broad and undefined

The best interests duty should be clearly defined in legislation as "best interests" has no meaning in the financial planning context. Without a well defined duty, the legislation will create a lot of uncertainty as to what is required to meet the duty, and lead to increased cost to advisers and consumers.

An undefined best interests duty will result in years of uncertainty and litigation before the position is resolved. In addition, the courts may interpret the duty as an outcomes based "best advice" obligation, which is contrary to the Government's stated policy that "the focus of the duty should be on how a person has acted in providing advice rather than the outcome of that action".[7]

In the meantime, the costs of providing advice will increase as advisers and licensees try to manage their risks. The cost of professional indemnity insurance can also be expected to rise to compensate for the increased risk of litigation if the duty is undefined, with the increased cost of doing business ultimately borne by consumers.

Another adverse outcome from a broad undefined duty will be that financial planning licensees will take different views as to what "best interest" means, and what they need to do to comply with the obligation. The result is that consumers will not receive the same, high standard from all advisers.

Recommendation:

The legislation should be amended to include a definition of the best interest duty which makes it clear how an adviser can comply with the best interest obligation.

BTFG recommends inserting the following new section 961B(1):

"The provider must act in the best interests of the client when providing advice, by:
(a) giving proper consideration to client interests; and
(b) complying with the duty of priority (section 961J)."

[6] Future of Financial Advice Information Pack 26 April 2010, page 2.
[7] Future of Financial Advice Information Pack 28 April 2011, Section 2.5.

3.2 The best interests duty is inconsistent with existing general law fiduciary obligations

The best interests provisions in the Bill do not override an adviser's general law fiduciary duty (which provides that the adviser must not obtain a benefit for themselves or a third party, and must not act in a conflict situation, unless they have the prior informed consent of the client). So advisers will have two regimes dealing with conflicts of interest, both of which they will need to comply with – one that requires that they obtain informed consent from the client and one that requires that they give priority to the client's interests.

Having two regimes will add to the regulatory burden and does not provide a clear and simple rule for advisers to follow and to explain to clients. Furthermore, the inconsistency between the two creates unnecessary complexity for financial planners.

<u>Recommendation</u>:

Insert a provision to make it clear that compliance with the best interests obligations will be deemed compliance with the general law fiduciary obligations.

For example, insert a new section 960B(2):

"Notwithstanding (1), a provider who complies with their obligations under Division 2 meets their fiduciary duties and obligations under any other law in connection with the provision of that advice, as does any authorised representative employer of the provider and the responsible licensee."

3.3. What is required to meet the reasonable steps defence is unclear

In terms of what the provider must do to meet some of the requirements under the reasonable steps defence, some of the requirements are still unclear.

Specifically, section 961B(2)(g) requiring the provider to "take any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances". The requirement is very broad and it is not clear what must be done to comply with the provision. Even the assistance provided by section 961E still requires an understanding of what it means to act in someone's best interests – which, as outlined above in 3.1 of this submission, is still undefined and not clear.

A lack of properly defined obligations will create a great deal of uncertainty for planners until the position is resolved through litigation, which will ultimately push up the costs of advice for consumers.

<u>Recommendation</u>:

Section 961E should be amended to deem compliance with section 961B(2)(g) if a person with a reasonable level of expertise in the subject matter and who was not in a position of conflict would have taken that step.

3.4 Clarification is required that an adviser can rely on its licensee's approved product list when investigating products for a client

A new section is required in the legislation to provide clarification that the best interests duty doesn't require an adviser to consider products that aren't on an approved product list.

If no clarification is provided, advisers may be forced to consider products that are not on the approved product list, even though their licensee will have researched (or engaged others to research) the products to form an approved product list.

Of course, where no product on an approved product list is appropriate for a client, the adviser will need to decline to advise the client, or alternatively follow a process to identify a suitable product that is not on the approved product list.

If advisers are expected to review a broad range of products in the market it will inevitably lead to an increase in time and effort by the adviser and ultimately an increase in cost for the consumer.

Recommendation: A new section should be inserted to make it clear that the requirement to conduct a reasonable investigation into financial products for a client does not require an adviser to investigate financial products that are not on an approved product list.

4. Scaled advice

BTFG strongly supports the Government's policy intent to facilitate "scaled advice" to help ensure that financial advice will be within the reach of a wider range of Australians. However legislative clarity and certainty is needed to enable the affordable delivery of scaled advice.

We note that the Government has stated that "to facilitate scaled advice, the Government will amend the existing reasonable basis for advice obligation in the Corporations Act to make it clear that this obligation is commensurate and scalable to the client's needs when providing advice. This will help address some concerns identified by the industry that the provision of scaled advice is not consistent with their obligations under the Corporations Act." [8]

However the current drafting of the best interests duty does not enable affordable scaled advice and will not achieve the Government's stated policy intent for several reasons which are outlined below.

4.1 The application of the best interest duty to the scoping of the advice will increase the cost of scaled advice

The Government has anticipated that scaled advice will be able to be provided by "a wide range of advice providers, including superannuation trustees (intra-fund advice is a form of scaled advice), financial planners and potentially accountants, creating a level playing field for people who provide advice"[9]. The current drafting of the best interests duty will not necessarily allow for a broader range of advice professionals to deliver scaled advice.

In order to offer limited advice or scaled advice offering to clients, advisers need to be able to agree the scope of advice with clients. However as currently drafted, the adviser has an obligation to act in the best interests of the client with respect to the scoping of the advice, as well as the giving of the advice. The outcome will be that the affordability and accessibility of scaled advice will be significantly compromised.

Practically speaking, the current drafting of the best interests duty will potentially mean that if a client only wants advice on a particular subject matter (i.e. scaled advice), then before the adviser can provide the advice the adviser must make inquiries into the client's overall objectives, financial situation and needs. Only then can the adviser determine if the subject matter or scope is in the client's best interests. In addition, apart from having to spend considerable time investigating the client's circumstances, all advisers will also need to be skilled across a broad range of financial advice so they can determine if the scope is in fact in the client's best interest. As a result, access to scaled advice will be significantly reduced as providers are unable to use advisers trained in a limited area only to provide the limited, scaled advice.

For example, a client may only want advice on life insurance. Before giving the advice, the adviser must determine if advising on life insurance is in the client's best interest. The result of the inquiries may be that it's actually in the client's best interests to have advice on a broader range of matters. But what if the client cannot afford more comprehensive advice, and simply wants to get their life insurance sorted?

Other professions are not subject to such requirements. For example, a lawyer whose client requests them to prepare a will is not required to consider whether it is in the client's best interests for the client to receive other legal advice unrelated to the will and is not required to potentially decline to prepare a will for them if not considered to be in the client's best interests.

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[8] Future of Financial Advice Information Pack 28 April 2011, Section 2.6.
[9] Future of Financial Advice Information Pack 28 April 2011, Section 2.6.

The customer will not have a positive experience if the adviser must determine what advice the client should be receiving and then potentially be required to refuse to provide the advice the client wants and can afford.

> Recommendation:
>
> Amend the best interests duty to make it clear that it applies in relation to the giving of advice only.
>
> For example, insert a new section 961B(1):
>
> *"The provider must act in the best interests of the client when providing advice, by:*
> *(a) giving proper consideration to client interests; and*
> *(b) complying with the duty of priority (section 961J)."*

4.2 To enable scaled advice the adviser and client need to be able to agree on the scope of the advice

The best interests duty as drafted in the Bill (Division 2 of Part 7.7A) only allows advice to be scaled at the request of the client, and not by the adviser or by agreement of both.

In order for a scaled advice regime to work, the adviser also needs to be able to delineate the scope with the agreement of the client because it needs to be a collaborative process in determining the scope of the advice.

While the drafting of the Bill does not reflect the ability of the client and the adviser to agree to the scope, the Explanatory Memorandum clearly envisages that this type of scoping discussion will take place (Corporations Amendment (further Future of Financial Advice Measures) Bill 2011 - Explanatory Memorandum - Paragraph 1.33).

Without being able to clearly agree the scope of advice, there will be great difficulty in designing and implementing affordable advice offerings. Allowing the client and adviser to agree a limited scope of advice after an initial discussion is beneficial to the client by ensuring that they only receive the advice they want and can afford. The adviser will only proceed if the client is happy with and agrees to the limited scope of advice and associated costs.

Any consumer protection concerns about advisers having clients agree to the provision of advice that they don't want, are appropriately addressed through existing remedies at law (e.g. for unconscionable conduct, duress, and misleading and deceptive conduct).

> Recommendation:
>
> The best interests provisions need to be amended to make it clear that advice can be scoped at the agreement of the adviser and the client.

4.3 Providing scaled advice through a computer program is not possible under the current drafting

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

However there are a number of issues with the draft legislation that need to be addressed in order to ensure that the provisions operate as intended. The Bill as currently drafted will not allow personal advice to be provided by way of a computer program and therefore does not allow for the provision of a broad scaled advice regime via the internet.

To enable more people to access quality, affordable advice it is crucial that advice be able to be provided through various mediums (including electronic). The current drafting of section 961(6) clearly recognises the need for electronic delivery of advice. However the current best interests duty drafting only allows advice to be scaled by the client which is not possible where the client is accessing advice online through a computer program. Some of the issues include:

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

- Where advice is being provided through a computer program, it must be possible for the computer program to be able to scope the advice. Providing advice through various mediums (including electronic) is crucial for more people to be able to access quality advice and it is clear that the current drafting of section 961(6) recognises this. However, the current best interests duty only allows advice to be scaled by the client, which is incompatible where the client is accessing advice online through a computer program.

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

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

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

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

Recommendation:

Insert a provision making it clear that advice can be scoped by a person providing advice through a computer program.

For example, insert section 961(7):

"Where advice is offered through a computer program, a reference to "advice" in this division refers to the subject matter or scope of the advice as specified by the person providing advice through the computer program."

Many of the other difficulties identified above with respect to providing personal advice through a computer program under the draft legislation will be resolved if the other issues with the best interests duty as identified in this submission are remedied. For example, ensuring the provisions only apply to an agreed scope and to permit a restricted approved product list to be used.

4.4 The appropriate advice requirement should be judged according to the client's relevant circumstances and the agreed scope of advice

The requirement for the resulting advice to be appropriate to the client (section 961G) is unclear, and needs amending so that it is clear that the test is whether the advice is appropriate for the client having regard to the client's relevant circumstances and the agreed scope of advice (as is the case with the current section 945A provision).

Without this clarity, a provider who gives advice on the agreed subject matter may be held to be in breach if a Court determines that it was not appropriate to receive advice on the agreed subject matter at all or if the advice was not appropriate by reference to personal circumstances that were not disclosed by the client to the adviser. The risks associated with providing affordable limited advice offerings in particular will be higher unless the provision is amended.

<u>Recommendation</u>:

Changes need to be made to section 961G such that the provider must only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client having regard to the client's relevant circumstances.

4.5 The requirement to ensure information is complete and accurate is too broad

The requirement to obtain accurate and complete information (section 961B(2)(c)) is too broad and may lead to unnecessary time and cost pressures on advisers which will ultimately increase the cost of advice for consumers.

Under the current drafting, if any of the information relating to the client's objectives, financial situation or needs is 'inaccurate' the adviser must make reasonable inquiries to obtain accurate information. The requirement is not limited to inaccuracies that are relevant to the provision of the advice, and could therefore capture typing errors or other minor inaccuracies in client information.

In some instances the adviser may only need to obtain an estimate or key information, rather than complete and accurate information. For example, if the client does not know the replacement value of a building for the purposes of obtaining advice on a general insurance product, the adviser should be able to rely on key information provided by the client in preparing the advice. However, the current wording of section 961B(2)(c) suggests that the adviser cannot just rely on the client's instructions and may need to verify the information, including checking with third parties. For example, the adviser may need to arrange a formal building valuation (at further expense to the client).

In addition, the legislation is not clear as to whether or not an adviser would need to make inquiries of 3rd parties in order to obtain complete and accurate information. The obligation could therefore require the adviser to go to unnecessary additional effort (and so additional cost for the client).

Recommendation

To ensure there is no unnecessary compliance burden, section 961B(2)(c) needs to be amended such that adviser only needs to make reasonable inquiries of the client to obtain information that is sufficiently complete and accurate for the purposes of providing advice on the agreed subject matter.

5. Conflicted remuneration ban

The Government's original policy intent was for "a prospective ban on conflicted remuneration structures, including commissions and any form of volume based payment. In addition, percentage-based fees (known as assets under management fees) can only be charged on ungeared products or investment amounts."[10]

On 28 April 2011, the Government announced that "there will be a broad comprehensive ban, involving a prohibition of any form of payment relating to volume or sales targets from any financial services business to dealer groups, authorised representatives or advisers."[11]

The key challenge is to eliminate payments that drive conflict while not undermining the effective functioning of the industry by banning <u>all</u> forms of payments including those which result from using scale to drive industry efficiency and hence bring down the overall cost to consumers. However the conflicted remuneration provisions in the Bill go beyond the Government's policy intent – and will actually increase costs across the value chain and ultimately to consumers.

The Westpac Group fully supports the ban on payments to advisers and AFSL license holders which result from their recommendation of specific or underlying products or investments. However the test for a conflicted payment should be when a payment results in an investor being sold a product that is not in their interests. In other words, the remuneration is conflicted if the adviser recommends products based on financial incentives they receive (commissions), rather than in the interest of their client.

Whilst banning conflicted remuneration payments is appropriate, the Government's current model goes further by banning legitimate, commercial business-to-business arrangements which do not relate to specific underlying products or investments.

5.1 Platform payments which are product neutral are captured in the ban

We have long held the position that volume payments from platforms to dealer groups are a commercial mechanism that, rather than creating conflicts in the provision of advice, create and reward scale for the benefit of consumers. Specifically:

- Platforms are a service that support the efficient administration of many underlying funds, ASX shares and products (hundreds of products in some cases)
- Platform payments to dealer groups based on scale of funds under administration are a commercial mechanism to create and reward scale, ultimately for the benefit of the end investor
- Platform payments to dealer groups based on scale in funds under administration do not create any potential for conflict in advice

However while the draft legislation allows market participants to show that a payment is not conflicted remuneration (section 963L), product neutral payments from platform operators to dealer groups are likely to still be prohibited because:

- Platforms are captured as a "financial product", even though in reality they are an administrative service (as recognised by the ASIC IDPS class order)
- Platforms will have difficulty proving that a payment will not influence the advice on the platform, as it will depend on how the dealer group deals with the payment,

[10] Future of Financial Advice Information Pack 26 April 2010, page 2.
[11] Future of Financial Advice Information Pack 28 April 2011, section 2.3.

remunerates its advisers and instructs its advisers with respect to the best interests duty, duty of priority, and appropriate advice

- The influence test is very broad and may unintentionally capture a situation where the dealer group's adviser receives a higher bonus for generating more advice fees from clients (irrespective of what product or platform is used)

In the same way that fund managers should be able to provide rebates and discounts on asset management fees to platforms for the scale efficiencies gained by the fund manager, the dealer group should be able to receive rebates for the scaled efficiencies gained by the platform, or the services the dealer group undertakes on behalf of the platform (e.g. many platforms do not have a customer call centre, instead the dealer group takes on this responsibility which provides efficiencies for the platform).

BTFG believes that platform payments to dealer groups do not create any conflict in advice if the payments are product agnostic (i.e. apply to the overall funds on the platform for which the range is sufficiently broad, with no bias towards underlying products).

<u>Recommendation</u>:

Insert a general exception that allows product neutral payments from platform operators to dealer groups.

5.2 The inclusion of general advice captures legitimate payments between product providers for outsourcing arrangements

Many payments are caught in the conflicted remuneration provisions due to the inclusion of general advice, including outsourcing arrangements made internally within a conglomerate or externally.

For example:

- <u>White labelled arrangements for share trading platform</u>. Where share trading platforms are outsourced to other financial institutions or white-labelled, a volume-based commission may be received that is based on the revenue received by the outsourced provider in relation to financial products traded through the platforms. However the licensee receiving the payment may be regarded as providing general advice to retail clients in relation to the trading platforms through marketing materials, offer documents and other means.

  The payment is not conflicted because the benefit is calculated based on the revenue as a whole and not in relation to any particular product within a class. However the conflicted remuneration provisions are drafted in a way that captures the situation outlined above.

- <u>Share brokerage payments</u>. In a similar way, platform providers may receive a share of brokerage charged by an outsourced service provider to clients for share trading facilities offered through the platform. The platform is considered to be providing general advice to retail clients in relation to the trading platforms through marketing materials, offer documents and other means and the receipt of brokerage may therefore be caught under this provision.

BTFG believes that the only way forward to cleanly and clearly resolve the above issues, without creating other unintended consequences, would be to carve-out general advice from the conflicted remuneration ban.

Recommendation:

We recommend the conflicted remuneration ban be amended so that is does not apply where general advice is provided. That is, the ban only applies to where personal advice is provided.

5.3 The execution only exception cannot be used by large financial services institutions

The execution only exception will not apply if the licensee or representative has previously provided advice to the client, including general advice. The draft legislation does not require that the prior advice provided be causally linked to the execution only service or that they be contemporaneous or provided around the same time.

As a result, large financial services institutions will not be able to rely on the exemption due to the fact that advice is likely to have been provided previously in marketing campaigns, in material issued by product issuers or by other advisers.

For example:

- Previous marketing campaign. If a previous general marketing campaign run by the licensee to prospective clients contained general advice relating to superannuation product (which many would), any representative of the licensee now or in the future will be unable to rely on the exemption for execution only services to those clients in relation to superannuation products.
- Previous advice – If an employed financial planner provided advice in relation to managed investment schemes as part of a financial plan 5 years ago to a client, any execution only services to the client in relation to managed investment schemes provided by a planner (of the same licensee) will not fall within the execution only exemption.

Recommendation:

The exemption should be amended to include a causal link between the advice provided now and the advice provided in the past; and require that it be for past advice given by the relevant representative (and not by any representative of the licensee).

For example, amend s963B(1)(c) as follows:

"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) the benefit is not for financial product advice in relation to the product, or products of that class, given to the person as a retail client by that licensee or representative;"

5.4 Client-directed fee for service payments through a product are captured in the ban

The Bill does not clearly exclude client-directed payments from the conflicted remuneration ban, where the payments are made out of a client's interest in a product. As such, we believe section 963B(1)(d) is contrary to the Government's policy intent.

The Government's announced policy intent is to "introduce an adviser charging regime" where "advisers will be required to agree their fees directly with clients".[12] Furthermore, the adviser charging regime was not intended to "prevent client-agreed deductions being allowed from a client's investment to pay for financial advice".[13]

The current drafting of section 963B(1)(d) requires payments to be "given ... by a retail client" if it is to be considered non-conflicted remuneration. However when a client directs a product issuer to make a payment through a product, the payment is generally as agreed or directed by the client but paid by the product issuer.

Recommendation:

The legislation should be amended to align with the policy announcement and made clear such that a client-directed or client-agreed payment, paid by the product issuer from the client's interest, is not conflicted remuneration.

From a superannuation perspective, the exception should be broadened to allow arrangements between trustees, members/clients, advisers and dealer groups to allow for adviser/dealer group remuneration.

For example, if an adviser charges the client a fee for service for advice and the client directs a platform/product to pay that fee out of their own investment, the remuneration should be considered non-conflicted.

The requirements in 963B(1)(d)(i) and (ii) should be deleted as it is not necessary or appropriate to limit the exception to client payments only in respect of product issue or advice.

[12] Future of Financial Advice Information Pack 26 April 2010, page 5.
[13] Future of Financial Advice Information Pack 26 April 2010, page 5.

6. Conflicted remuneration ban – impact on employee remuneration

The Westpac Group strongly supports the carve-out for basic banking products from the conflicted remuneration ban as sensible policy that recognises that there needs to be flexibility to allow routine retail banking operations to continue, particularly when such operations are relatively simple and easily understood by customers.

However the ban on conflicted remuneration as it applies to employee remuneration may not always provide the right outcome for consumers and will reduce access for working Australians to free simple general advice.

6.1 The conflicted remuneration ban will reduce consumer access to general advice

The limiting of the carve-out for employees of Authorised Deposit-taking Institutions (ADIs) to basic banking products has produced, what we believe to be, some unintended consequences in that it will compromise the ability of banks to continue to provide information or general advice about simple wealth and protection products to consumers from bank branches. Consumer access to these products via banks is critically important since many consumers will not be able to afford to seek personal financial advice, including scaled advice that would in turn introduce them to some of these products.

Banks have also made a considerable investment in creating (or developing) simple, low cost superannuation products such as our BT Super for Life product that responds to the Government's objective of having an increasing number of Australians in superannuation products that are simple and commission free. BT Super for Life has now been accessed by over 300,000 customers – who have transferred to a no commission, low-cost product which is offered under a general advice model.

The Westpac Group has also invested considerably in training and educating staff in how these products work and how to determine whether they meet customer needs. In the future we similarly see simple managed investments and insurance products playing an important role in helping people grow and protect their wealth. Access to these simple wealth and protection products via bank branches, which will cater for current and future needs, is important for customers who may not have ready access to a financial adviser either through issues of affordability, apathy or disengagement.

For example:

- Free assistance to help people find their lost super and consolidate accounts, such as the campaign undertaken by Westpac in June/July 2011 which was supported by Minister Shorten. Providing similar free assistance in the future would prove difficult and near impossible without the ability to encourage staff to spend the considerable time needed to help customers consolidate.[14]
- Any new MySuper product, which will be low cost, simple and commission free while also existing in a much more highly regulated environment, will not be able to be effectively distributed by banks.

<u>Recommendation</u>:

The conflicted remuneration ban needs to be amended so that it does not apply where general advice is provided.

[14] Financial Services and Superannuation Minister Bill Shorten said "The government is congratulating Westpac in reuniting people with their lost super," (Source: Investor Daily 29 June 2011).

7. Volume-based shelf space fees

The Government's stated policy intent is to ban "any volume-based shelf-space fees which are paid from the fund manager to the platform provider and from the platform provider to the licensee."[15] In addition, shelf space fee payments not based on volume would be permitted.[16]

However the drafting of section 964 and 964A is broader than the stated policy intent. Furthermore, the exemption from being considered a volume-based shelf space fee if the payment represents efficiencies is impractical and difficult to prove.

7.1 The shelf space ban is broader than the policy intent

As stated above, the Government's stated policy is that only volume-based shelf space fees paid by a fund manager to a platform provider would be banned. The Explanatory Memorandum to the Bill states that volume based benefits to platform operators are banned "to the extent that such incentives are merely a means of product issuers or funds managers 'purchasing' shelf space or preferential positions on administration platforms."[17]

The draft legislation is much broader than the stated policy intent due the definition of "funds manager" and so captures many other payments.

The definition of "funds manager" includes any licensee or RSE licensee that deals in a financial product to which the platform is related. As a result "funds manager" includes, for example, both general and life risk insurers.

<u>Recommendation</u>:

The volume-based shelf space ban should be limited to payments from fund managers to platform operators only, as per the announced policy. A new definition of "funds manager" is required to ensure other payments are not captured.

For example:

*"**funds manager** means a responsible entity of a registered scheme or an RSE licensee who issues their financial products to retail clients through the platform operator's custodial arrangement by having them available on the investment menu of the custodial arrangement."*

7.2 A platform operator will not know the scale efficiencies gained by the fund manager

Section 964A(3)(b) does not presume payments are a volume-based shelf space fee if the payment is a reasonable fee for service, or represents efficiencies gained by the fund manager.

BTFG understands that the provision was inserted to ensure that the following types of payments were permitted:

- Payments from the fund manager to the platform for services taken on by the platform. For example, providing a customer call centre and statements to customers invested in the fund manager. By being on the platform, the fund manager no longer has to deal with inquiries from individual customers, nor issue individual statements.

[15] Future of Financial Advice Information Pack 28 April 2011, Section 2.3.
[16] Future of Financial Advice Information Pack 26 April 2010, page 14.
[17] Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 - Explanatory Memorandum section 2.50, page 35.

- Asset management fee rebates which effectively provide a scale discount on the fund manager’s asset management fee. That is, the platform invests into the fund manager’s public offer investment pool and receives a rebate back each month to reflect a discount to the headline asset management fee. The size of the discount will depend upon commercial negotiations between the fund manager and the platform.

However 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.

As a result, proving scale efficiencies for the fund manager is difficult for the platform and further guidance as to how it is possible to prove scale efficiencies is needed.

Recommendation:

Further legislative guidance should be provided as to how it will be possible to prove that efficiencies have been gained by the funds manager.

For example, a reasonable way to prove efficiencies gained may be through a bona fide arms length negotiated agreement between the funds manager and the platform operator.

8. Soft dollar benefits

The ban on soft-dollar benefits (non-monetary benefits) in section 963C contains several issues which seem to be unintended.

8.1 The current drafting can prohibit licensees and representatives from obtaining benefits that they pay for

The current drafting of section 963C is broad enough to prohibit benefits purchased directly by the licensee or representative in some circumstances. For example, a licensee may pay for independent research from a research provider, or technical services from a service provider – both of which would be considered non-monetary benefits:

- The research information purchased may contain a buy/sell/hold recommendation, and as such could reasonably be expected to influence the choice of financial product recommended, or the advice provided by the licensee.
- The technical assistance purchased may also ultimately influence the adviser's choice of product or advice recommendation and could therefore be banned (if not otherwise exempt under section 963C(c)). E.g. technical information comparing the different social security treatment of different financial product types, or technical information explaining the types of superannuation contributions people can make and their tax and preservation treatment.

Banning non-monetary benefits that have been purchased by the licensee or authorised representative does not seem to be the policy intent. As such, the inclusion of these benefits under the ban seems to be an unintended consequence of the current draft legislation.

Recommendation: An exception should be included in section 963C to exclude non-monetary benefits that have been paid for by the licensee or authorised representative.

8.2 Legitimate and valuable educational services will be banned

The education exemption from the soft-dollar ban in section 963C(c) currently only exempts educational or training benefits which are linked to advice.

However many legitimate and important education sessions are run by product providers which relate to matters other than the provision of financial product advice. For example, practice management, soft skills (e.g. client relationship skills), and general economic/market information.

A broader exemption should be available for education or training benefits where the purpose is not to influence advisers to recommend a particular product.

Recommendation: Section 963C(c)(ii) needs to be deleted as it is unnecessary, and the exemption needs to be broadened to allow for legitimate education and training which does not influence advisers to recommend a particular product.

8.3 The IT software exemption is not equitable across the industry, and will not encourage the best software to be used

The IT exemption as drafted in section 963C(d) only applies where the software benefit is related to the advice on products issued by the IT benefit provider. That is, the exemption will only apply where the software is provided by the product issuer.

As the exemption is drafted, product issuers that source the best IT software from a third party, instead of building the software in-house, would not be able to rely on the exemption.

In addition, some product issuers may not have the relevant skills or expertise in IT, or may not be able to build the software as efficiently as an external supplier. So in some circumstances, outsourcing the software or IT support services may be more prudent. We do not believe product issuers should be disadvantaged if they choose to outsource IT software, if benefit is related to the advice on products issued.

The issue seems to be an unintended consequence of the drafting of the exemption.

Recommendation:

The IT exception needs to be amended so that it applies where the benefit is the provision of information technology software or support by, or on behalf of, an issuer or seller of a financial product. That is, the exemption should apply whether the product issuer builds the software itself or uses a third party supplier.

In addition, the current drafting of the exemption would mean that IT software which allows for applications and disposals of financial products (i.e. other dealing activities) would not fall within this exception.

We believe the exemption should be extended to cover all financial services (not just advice) so that where the IT software facilitates other dealing services it is permitted.

Recommendation:

The IT exemption should be amended to include technology software provided or supported by, or on behalf of, an issuer of a financial product.

For example, amend section 963C(d) as follows:

"the benefit satisfies each of the following:

(i) the benefit is the provision of information technology software or support by, or on behalf of, an issuer or seller of a financial product ("IT benefit provider");

(ii) the benefit is related to the provision of financial services to persons as retail clients in relation to the financial products issued or sold by the IT benefit provider;

(iii) the benefit complies with regulations made for the purposes of this subparagraph;"

9. Ban on asset-based fees on borrowed amounts

The policy intent of banning asset-based fees on borrowed amounts is to remove the potential conflict created by additional fee income derived by the adviser, purely from a recommendation to gear[18]. However the draft legislation goes further than is necessary to achieve the desired policy intent.

9.1 Ban on asset-based fees on borrowed amounts captures some product issuer fees

Section 964D and section 964F of the legislation ban a financial services licensee from charging an asset-based fee on a borrowed amount used to purchase a financial product, where the licensee charges the fee for financial product advice to a retail client. The legislation as currently drafted, bans asset based fees on borrowed funds where either personal or general advice is provided.

The extension of the ban to general advice has unintended consequences for product issuers and may prohibit product issuers from charging asset-based fees on any of the invested monies which are borrowed funds. The reason is that product issuers are financial services licensees and usually provide general advice to clients through marketing material, offer documents, websites, and call centres.

As a result, product providers cannot charge product fees (such as administration fees or asset management fees) on a client's account where the product provider provides general advice to the client and where it is "reasonably apparent" to the product provider (the licensee) that the investment is from borrowed funds. Even if the product provider is aware the funds come from borrowed amounts, the product provider has a legitimate right to recoup product fees from the investor as it does for all investors.

Prohibiting product providers from charging legitimate asset-based product fees on investments made with borrowed monies does not seem to be the Government's policy intent.

Recommendation:

The cleanest way to resolve the issue, and not unintentionally capture legitimate asset-based product fees, is for the legislation to be amended such that the ban on asset-based fees on borrowed amounts only applies where the licensee charges the fee for the provision of *personal advice*.

9.2 Product providers who are only facilitating the payment of adviser fees through the product may not know if the amount is borrowed

A fee for service (or a fee for advice) charged by a financial adviser is often paid by the client through their holdings in a product rather than being paid direct. To make the payment to the adviser, a product issuer can only act on a client's instructions.

However the drafting of section 964D effectively bans the product provider from charging the client for advice fees if the fee is asset based and on a borrowed amount. The issue is that the product provider may not be in a position to know if the investment was made from borrowed monies, and the burden of proof under the "reasonably apparent" test would be costly and onerous for the product provider and the customer. 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.

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[18] Future of Financial Advice Information Pack 2010, page 4.

Whilst BTFG supports the policy intent to ensure that the adviser does not charge an asset based fee on borrowed amounts, a product issuer should not be banned from making a payment for the fee for advice or penalised if they are simply acting on the client's instructions.

Product providers that merely facilitate the payment for the fee for advice should be exempted and not penalised.

Recommendation: A specific exemption needs to be inserted for product providers that are only facilitating the payment of adviser fees through the product.

10. Insurance

The current definition of a group life policy in the Bill captures arrangements entered into by superannuation platforms for the purpose of achieving and passing on scale efficiencies to fund members.

Many superannuation platforms, which are not default super funds and which won't be a MySuper fund, are able to hold individually advised and tailored policies under a single contract with an insurance provider. That is, the individual member receives a tailored product based on advice from their financial planner but for efficiency reasons the platform holds all of these policies under a single contract with the insurer.

The legislation captures the arrangement outlined above under the definition of group policy, creating an artificial distinction between:

(i) A policy established within an SMSF (commission can be paid on this policy).

(ii) A policy established within a platform, where the RSE trustee has entered into an individual contract with the insurance provider for each policy held (commission can be paid on this policy).

(iii) A policy established within a platform, where the RSE trustee has entered into a single contract with the insurance provider against which all individual insurance is tailored and underwritten (the legislation does not allow commission to be paid on this policy).

The outcome is that platforms which hold separate legal contracts for each individual policy (as per (ii) above) have an advantage over platforms that, for scale-efficiency reasons have a single contract for all individual policies (as per (iii) above).

<u>Recommendation</u>:

The definition of "group life policy" needs to be amended such that individually tailored and underwritten cover is not captured. That is, it only captures situations where the product provides a pre-determined level of cover to the client.

For example:

1. Additional criteria could be added to the end of the definition in s.963B(2):

"...and any of the following applies:

(a) the product provides a pre-determined level of cover to the members of that class;

(b) the product provides a pre-determined level of cover to members of that class based on the member's characteristics, which may include their age and gender; or

(c) the product provides a selection of pre-determined levels of cover to the members of that class, from which the member must choose."

2. Alternatively, the following wording could be added to the end of the definition in section 963B(2):

"For the purposes of this Division 4, cover provided in the following circumstances is excluded from the definition of group life policy for members of a superannuation entity:

- *the member receives financial product advice in relation to the insurance cover from an individual representative of a financial services licensee and the benefit is provided in relation to that advice; and*
- *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."*

3. Transitional provisions

The Government has clearly stated that the policy was to introduce "a prospective ban on conflicted remuneration structures, including commissions and any form of volume based payment".[19]

Furthermore, Minister Shorten in his second reading speech for the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, said that the measures "represent a large change to the industry and to individual businesses. It is for this reason that existing trail commission books will be 'grandfathered'. This means that commissions from business entered into prior to the reforms can continue. Of course, commissions on new business and clients after 1 July 2012 will not be allowed."[20]

BTFG strongly supports the view that all commissions and volume payments under existing arrangements should be grandfathered. However section 1528 of the Bill excludes all conflicted remuneration given by a platform operator from the transitional relief. Given commissions are a form of conflicted remuneration, the provision thereby provides no grandfathering of commission paid by platform operators even though commissions would be allowed from other financial services providers. The Bill therefore creates an unlevel playing field and unfairly disadvantages platform operators.

The Explanatory Memorandum is also ambiguous and internally inconsistent in relation to grandfathering as it applies to platform operators. The Explanatory Memorandum, paragraph 2.71, states that the transitional arrangements "do not apply to conflicted remuneration given by a platform operator" and that these payments will be banned from the date of commencement. However the Explanatory Memorandum then goes on to state in paragraph 2.72 that it is intended to provide for payments made by platform operators under the regulations.

So the intention in relation to the grandfathering of platform operator volume payments is unclear. Furthermore, given the legislation clearly prohibits the grandfathering of conflicted remuneration we do not understand how the regulations may subsequently provide for it.

Notwithstanding the different proposed treatment of conflicted remuneration provided by platform operators compared to other financial services licensees and product providers, the Bill needs to be amended to ensure that the legislation does not have retrospective effect.

Recommendation: Part 10.18 of the Bill should be amended to clearly provide that all conflicted remuneration given by a platform operator (including commission and volume payments), under an arrangement entered into before the commencement of the legislation, should be grandfathered and not prohibited.

[19] Future of Financial Advice Information Pack 26 April 2010, page 2.
[20] Source: House of Representatives Hansard, 24th November 2011.