22 December 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

By email: corporations.joint@aph.gov.au

Dear Sir/ Madam

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

CPA Australia, the Institute of Chartered Accountants in Australia, and the Institute of Public Accountants (the Joint Accounting Bodies) represent over 190,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We welcome the opportunity to comment on the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* (FoFA Bill).

The best interests duty and conflicted remuneration are key elements of the FoFA reform package and are integral to achieving the original stated objectives of improving the trust and confidence of Australian retail investors in the financial planning sector

The complexity of the financial products, the volatility of the financial markets, the increased onus on consumers to make active financial decisions including through compulsory superannuation and the low levels of financial literacy further underpin the need to ensure the quality of financial advice provided to consumers. More and more consumers are being encouraged to be actively engaged with their finances and seek professional financial advice.

The Joint Accounting Bodies believe the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory best interests obligation will embed this motivation in the financial advice framework to ensure all financial planners make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates. We believe introducing this obligation will improve the public's trust and confidence in the advice they receive.

The removal of conflicted remuneration structures, which include commissions and volume-based payments, is also pivotal to achieving the objectives of the FoFA reforms and to ensure all advice is focused on the needs of the client. We believe this will further strengthen consumer confidence and trust in financial advice.

This reform would not only address any real conflicts that may exist, but will also importantly assist in addressing lingering negative perceptions some consumers may have of the financial planning industry. For these reasons, the Joint Accounting Bodies have long supported the removal of conflicted remuneration.

While the Joint Accounting Bodies support the legislation's endeavours to remove conflicts of interest, we believe that all payments deemed to be conflicted remuneration should be regulated consistently. We are concerned that the proposed carve-outs may in fact weaken the effectiveness of the overall reforms and add a further level of administrative and compliance complexity.

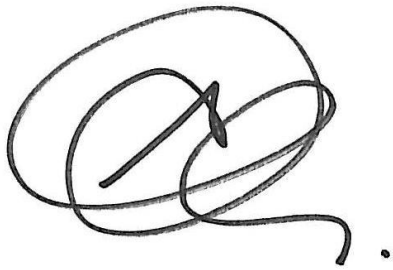
These reforms will require some industry participants to make significant changes to how they currently operate and appropriate time must be allowed to ensure an effective transition. The Joint Accounting Bodies are pleased that ASIC has acknowledged this in their recent announcement which states it will adopt a facilitative compliance approach for the first 12 months of the implementation of the FoFA reforms and will also release further regulatory guidance on the impact of the reforms.

In regards to the specific requirements of the Bill, the key recommendations raised in our submission are as follows:

- The best interests obligation should be extended to include advice provided to wholesale clients.
- All commissions on life risk insurance products, including those sold within or outside of superannuation, should be consistently regulated. Given their potential to cause real or perceived conflicts of interest, commissions should not be carved-out under section 963B.
- Execution-only sales should not be carved-out under section 963B, as this exclusion may lead to an inherent conflict between remuneration models where advice is and is not provided. Further, it may also encourage licensees (and financial planers) to move away from providing financial advice.
- A platform operator should only be allowed to receive an asset management fee discount in the form of a rebate on the basis that it represents reasonable scale of efficiencies and if the value of this rebate is passed on to the clients invested in the respective fund.
- Asset based fees should be banned where there is any leverage involved in the retail client's investment portfolio to ensure the reform achieves the correct policy outcomes.

If you have any questions regarding this submission, please do not hesitate to contact Keddie Waller (CPA Australia) at keddie.waller@cpaaustralia.com.au, Hugh Elvy (the Institute) at hugh.elvy@charteredaccountants.com.au or Reece Agland (IPA) at reece.agland@publicaccountants.org.au.

Yours sincerely



Alex Malley
Chief Executive Officer
CPA Australia Ltd

Graham Meyer
Chief Executive Officer
Institute of Chartered Accountants in Australia

Andrew Conway
Chief Executive Officer
Institute of Public Accountants

1. Best interests obligations

The Joint Accounting Bodies believe that the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory 'best interests' obligation will embed this obligation in the financial advice framework. This will ensure providers of financial advice make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates.

The proposed obligation achieves an appropriate balance of maintaining the principal of the obligation while providing appropriate guidance as to what is required to satisfy the duty. This balance should positively encourage behavioural changes that will be in the public interest.

The best interests obligation is intended to only apply to personal advice provided to a retail client. However, the Joint Accounting Bodies believe this obligation should be extended to include financial advice provided to wholesale clients. While we understand the Government is yet to announce their view on the appropriateness of the current distinction between wholesale and retail clients, the fact of the matter is that advice provided to wholesale clients should still be in the best interests of the client. Further, the provider of the advice should be required to give priority to the interests of the client over their own interests, or the interests of their licensee or any associate of the licensee.

All financial planning advice must be in the client's best interests, irrespective of whether the client is classed as a retail or a wholesale investor. Choosing to exclude advice provided to wholesale clients from the best interests obligation could be perceived as recognition that this advice may in fact not always be in the best interests of the wholesale client. We do not believe this is in keeping with intention of the FoFA reforms.

Recommendation:

- **The best interests obligation should be extended to include advice provided to wholesale clients.**

2. Conflicted remuneration and other banned remuneration

While the Joint Accounting Bodies support the legislation's endeavours to remove conflicts of interest, we believe that all payments deemed to be conflicted remuneration should be regulated consistently.

We are concerned that the proposed carve-outs may in fact weaken the effectiveness of the reforms and potentially add further complexity for advice providers and consumers.

Section 963B Monetary benefit given in certain circumstances not conflicted remuneration

Life insurance products outside superannuation and within non-default superannuation funds

The Joint Accounting Bodies are of the view that all commissions have the potential for real and perceived conflicts of interest and should therefore be banned. Remuneration models based on a commission structure do not align with the services generally provided by a professional. However, we recognise the practical implications this entails and any change requires an appropriate and practical transition period.

We believe the inconsistency in how commissions on insurance for life risk products sold outside of superannuation and individual life risk policies within superannuation for non-default funds adds unnecessary complexity. Further, it encourages the retention of conflicted remuneration models.

All payments deemed to be conflicted remuneration should be regulated consistently.

Choosing to not ban conflicted remuneration on life risk insurance products in these specific circumstances, irrespective of the best interests obligation, risks the continued provision, perceived or real, of inappropriate advice to consumers who seek advice on these products.

The Joint Accounting Bodies do not believe there are sufficient grounds to warrant these products being excluded from the regulation proposed to apply to other like products. Such 'carve-outs' add complexity and cost to the provision and administration of advice, which will ultimately be passed on to the consumer.

On 28 April 2011 the Government stated that banning all forms of commissions within superannuation is in the best interests of consumers[1].

This position is consistent with the recommendation 5.12 of the *Cooper Review:*

Upfront and trailing commissions and similar payments should be prohibited in respect of any insurance offered to any superannuation entity, including to SMSFs, regardless of rules on commissions that might apply outside superannuation.

It is also consistent with the findings of ASIC, where in *Report 69 Shadow Shopping survey on superannuation advice* they found that unreasonable advice was three – six times more common where the adviser had an actual conflict of interest over remuneration (e.g. commissions) or recommending associated products[2].

For this reason the Joint Accounting Bodies recommend that commissions on all life risk insurance products are consistently regulated, including those within and outside of superannuation. Further, given their potential to cause real or perceived conflicts of interest, they should not be carved-out under section 963B.

Recommendation:

- **All commissions on life risk insurance products, including those sold within or outside of superannuation, should be consistently regulated. Given their potential to cause real or perceived conflicts of interest, commissions should not be carved-out under section 963B.**

Execution-only sales

While we understand the objective of the draft legislation is to ban the receipt of certain remuneration by licensees which may have the potential to influence advice, we recommend the ban should be extended to include execution-only sales.

The proposed carve-out may motivate behaviour which encourages execution-only sales and lead to an inherent conflict between different remuneration models where advice is and is not provided. It may further encourage licensees to provide execution-only sales rather than provide advice.

Non-advice or execution-only services is in simple terms an administration service and as a result a remuneration model should align with the actual service being provided (e.g. fixed fee / flat dollar) as opposed to a remuneration structure based on sales.

[1] Future of Financial Advice 2001 Information pack, 28 April 2011 p.7

[2] ASIC Report 69 – Shadow shopping survey on superannuation advice p.2

Given the potential conflicts between different remuneration models and that this exclusion may encourage licensees to (intentionally or unintentionally) move away from providing financial advice, the Joint Accounting Bodies recommend that execution-only sales are not carved out under section 963B.

Recommendation:

- **Execution-only sales should not be carved-out under section 963B, as this exclusion may lead to an inherent conflict between remuneration models where advice is and is not provided. Further, it may also encourage licensees (and financial planers) to move away from providing financial advice.**

Section 964A Platform operator must not accept volume-based shelf-space fees

The Joint Accounting Bodies believe that a platform operator should only be able to receive an asset-management fee discount in the form of a rebate, where it represents a reasonable value of scale efficiencies, if the value of this rebate is passed on to clients invested in the respective fund manager.

We believe there is a risk in allowing the industry to maintain forms of conflicted remuneration if the licensee can continue to receive this rebate, where the discount should rightfully be received by the client.

Recommendation:

- **A platform operator should only be allowed to receive an asset management fee discount in the form of a rebate on the basis that it represents reasonable scale of efficiencies and if the value of this rebate is passed on to the clients invested in the respective fund.**

Subdivision B Asset-based fees on borrowed amounts

As drafted, a licensee will be permitted to charge an asset-based fee on the ungeared component of a retail client's funds but not the geared component. However, previous stakeholder consultation had indicated that for this reform to have appropriate effect the ban should apply where there is any leveraged component involved in a retail client's investment strategy.

We believe permitting an asset based fee to be charged on the 'ungeared' component of a retail client's funds will create confusion for the consumer, who may as a result of this policy decision be charged via multiple remuneration models. Further, it risks licensees and their representatives adjusting pricing structures so a nil fee or a very low fixed / flat fee may be payable on the geared component of the investment fund and a higher asset-based fee is charged on the ungeared component of the investment fund. The end result is that the payment is the same dollar value as would have previously been the case where an asset based fee is paid over the entire investment amount.

Complex remuneration models may also lead to increased administration and compliance costs, which will inevitably result in the consumer having to pay a higher fee to access advice.

Further, it may result in even more confusing and complex disclosure statements being provided to consumers should the annual disclosure statement and opt-in requirements be implemented.

The Joint Accounting Bodies do not believe such outcomes would be in the public interest, nor would they remove complexity from the advice charging process. For this reason we recommend that asset based fees be banned where any component of the overall advice involves gearing.

Recommendation:

- **Asset based fees should be banned where there is any leverage involved in the retail client's investment portfolio to ensure the reform achieves the correct policy outcomes.**