22 December 2011

Mr Shon Fletcher
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 Mr Fletcher,

Submission by MLC and NAB Wealth (MLC) Ltd to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry (PJC) into:

- **Corporations Amendment (Future of Financial Advice) Bill 2011; and**
- **Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.**

MLC & NAB Wealth (MLC) welcome the opportunity to comment on the Corporations Amendment (Future of Financial Advice Measures) Bill 2011, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 and their associated explanatory memoranda (EM). MLC has also contributed to relevant industry body submissions including the Financial Services Council (FSC), the Australian Bankers Association (ABA) and the Association of Superannuation Funds of Australia (ASFA).

MLC notes that the Future of Financial Advice (FoFA) package forms the Government's response to the Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services 2009 (Storm PJC) has been guided by two overriding principles:

- 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
- In minimising these distortions, financial advice should not be put out of reach of those who would benefit from it.[1]

1 The Hon. Chris Bowen, The Future of Financial Advice, Information Pack, Monday, 26 April 2010

MLC has long supported the overriding principles behind the FoFA reforms. MLC believes that the changes brought in will substantially benefit both the industry and consumers and will fundamentally improve how parts of the industry are operating today. Further, properly implemented, FoFA will also enhance professional standards in the industry, improve transparency for clients and build more trust and confidence in financial planners, giving Australians more confidence in seeking financial advice.

Should you require further information on this submission please direct your initial inquiry to MLC Government Affairs:

Yours sincerely,

Steve Tucker
Chief Executive Officer
MLC

Executive Summary

- MLC does not support the proposed annual Fee Disclosure Statement (FDS), particularly given the amount of disclosure already required. However, if it is introduced, we consider it should only be required for new clients from the commencement of the FoFA reforms;

- There should be an alignment of the commencement of the FoFA ban on conflicted remuneration with the introduction of MySuper as the mandatory fund (for contributions for employees who have not exercised a choice in relation to a fund); and a transitional 2 year implementation timeframe for both FoFA and MySuper before sanctions apply; and

- There is a possible unintended conflict between the stated policy and the draft legislation, whereby an adviser providing individual advice on insurance in superannuation could be potentially subject to the ban on commissions for group insurance.

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Annual Fee Disclosure Statement

The first tranche of FoFA proposes a FDS which applies to both new and existing clients that requires advice fees and services provided in the preceding 12 months, and anticipated fees and services in the next 12 months to be made explicit.

In the Storm PJC, a key Term of Reference was '*the need for appropriate disclosure'.* The recommendation from the PJC was for the Corporations Act to be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide for consumers and any potential conflicts of interest.[2] Importantly, the PJC did not recommend the introduction of additional fee disclosure requirements. Little commercial benefit would be realised from this additional requirement.

MLC notes there are extensive existing disclosure requirements, such as:

- Legislative requirements - s946A (Statement of Advice) and s941A Financial Services Guide;
- The FSR legislation - requiring financial planners and licensees to disclose all fees to clients;
- Advice fees being included in annual statement requirements of superannuation funds and product providers; and
- ASIC Regulatory Guides.

MLC conservatively estimates that the cost to implement FDS for MLC super (i.e. excluding Managed Investment Schemes) will be between $3-6 million and $500,000 ongoing per annum. MLC believes that this requirement was not intended by the original policy and is unlikely to deliver a superior customer outcome, yet imposes significant costs on the Advice process. The FDS will be a duplication of the existing system and will require extensive and expensive system changes, adding significant costs to the provision of advice to the industry and ultimately to consumers. It should be noted that existing product disclosure in superannuation and Managed Investment Schemes provide a dollar fee disclosure with the exclusion of whole of life and endowment products.

While MLC does not support the FDS, MLC believes that if the FDS is to be implemented, similar to the opt-in provision, the requirement to provide a **FDS should apply only to ongoing fee arrangements entered into on or after the commencement date of the reforms**. This

2 P 150, Parliament Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, November 2009

will significantly reduce the cost of implementing the FDS and achieve consistency with the opt-in requirements.

Timing and Implementation of FoFA

MLC believes that transitional arrangements are essential to enable the financial services industry sufficient time to implement these reforms. With the referral of both tranches of the legislation to the PJC and the Senate Economics Committee, it is most likely that the FoFA legislation will not pass Parliament until at least the end of the first quarter 2012 and most of the obligations are due to commence 1 July 2012. This compressed timeframe between the legislation being passed and the commencement date is not adequate for the proper preparation to comply with the new legislative obligations.

Referral of related Bills to Parliamentary Committees may result in a delay to the final passage of the Bills with the additional risk of late amendments. In addition, the industry relies on having completed laws to accurately develop systems and processes which we feel confident will comply with requirements. Any timetable for significant change requires appropriate structures for providing information on requirements and costs. This period encompasses: an analysis and economic impact assessment; a design phase; funding assessment and application; resource mapping and engagement; along with amendments to legal contracts (which may require external resources); disclosure and communication; and building, testing and launching the initiatives.

Further, at the time of writing, the final components of FoFA have not been released, including the retail/wholesale mandated definitions which have a significant impact on other aspects of FoFA (affecting conflicted remuneration).

Alignment of FoFA and Stronger Super dates

To ensure the industry manages to implement and comply with the full suite of provisions related to the FoFA and MySuper policies, MLC recommends the following:

- **Alignment of the FoFA ban on conflicted remuneration with the date employers must make contributions for employees who have not made a choice of fund to a fund that offers MySuper (1 October 2013); and**
- **A transitional 2 year implementation timeframe for both FoFA and MySuper before sanctions apply.**

Intra-Fund Advice

MLC believes the parallel between FoFA and Stronger Super will have a significant impact on how intra-fund advice may be provided to fund members. The provision of intra-fund scaled advice is contemplated in the Stronger Super Reforms. Thus, it is imperative that the FoFA legislation be considered in conjunction with the introduction of MySuper. Importantly, the FoFA legislation cannot be considered in isolation due to the potential related impacts which may affect the viability of providing intra-fund advice.

"Intra-fund advice will be subject to key FoFA regulatory requirements, such as the best interests duty, thereby promoting a level playing field with other forms of financial advice. In addition, this definition provides safeguards by restricting the types of financial advice that can be provided under the guise of intra-fund advice." [3] – The Hon. Bill Shorten

In July 2011, ASIC released Consultation Paper 164: *Additional guidance about how to scale advice* and ASIC intends to have the final guidance released before 1 July 2012. The lack of a known date for the regulations continues to create uncertainty in the industry, impacting our capacity to re-engineer our systems. We note the Minister announced that intra-fund advice would be included in the second tranche of the FoFA reforms.[4]

Standard Employer Sponsored Members

The FoFA and MySuper starting dates for 'standard employer sponsored members' need to be aligned to commence at 1 October 2013. Our existing 'standard employer sponsored arrangements', which must be managed into the MySuper regime (from 1 October 2013), would need significant additional expenditure to make them compliant with FoFA at 1 July 2012.

MLC has estimated that it would cost MLC in excess of $10 million to make the standard employer sponsored arrangements FoFA compliant for one year leading up to the start date of MySuper. There will also be further significant expenditure to move arrangements into a MySuper compliant arrangement for new contributions. As previously noted, there is currently less than 8 months before the proposed commencement date and ASIC has not committed to the date before 1 July 2012 by which the draft regulations will be finalised.

Given there is an explicit transition rule which imposes a retrospective ban on commission via mandatory conversion of all existing default arrangements to non-commission MySuper product

3 The Hon. Bill Shorten, Press Release, 8 December 2011, Future of Financial Advice Reforms – Improving Access to Simple Financial Advice

4 The Hon. Bill Shorten, Press Release, 29 August 2011, Future of Financial Advice Reforms – Draft Legislation

in 2017, we believe it is both reasonable and prudent to align the FoFA and MySuper start dates. At the very least, the alignment could apply in respect to 'standard employer sponsored arrangements'[5]. This could be managed as part of the grandfathering provisions for FoFA.

There is a precedent for a 2 year transition period as was provided for *the Financial Services Reform Act 2001*(FSR) and the Registrable Superannuation Entity licensing amendments to *the Superannuation Industry (Supervision) Act* (*the Superannuation Safety Amendment Act 2004*).

To provide certainty and to assist the industry with the significant planning required to undertake these reforms**, MLC believes there needs to be a delay to the start date of FoFA to 1 October 2013 (for conflicted remuneration), along with a rolling 2-year transition.**

Grandfathering

There is the real potential that the provisions relating to grandfathering may capture existing arrangements (such as trail commissions) where they are paid from particular products, but may fail to appropriately grandfather trail commission payments which are made from platforms. MLC believes this is contrary to the stated position of the Minister (see below).

"…in relation to trail commissions on individual products or accounts, any existing contract where the adviser has a right to receive a trail commission will continue after 1 July 2012, or in the case of certain risk insurance policies in superannuation, 1 July 2013. This means that trail commissions will continue to be paid in these circumstances." [6] – The Hon. Bill Shorten

MLC supports the Minister's stated position in respect to grandfathering for trail commissions to help provide an effective and viable transition to the 'new world' environment. We believe this issue is a technical oversight in the drafting and would **ask that the legislation be clarified to ensure that trail commissions from both platforms and products are appropriately grandfathered**. MLC also seeks further clarity both for conflicted remuneration, anti-avoidance and grandfathering provisions.

5 The provisions providing this extension in the start date for FoFA to align with the MySuper start date could be drafted by reference to s16(5) of the Superannuation Industry (Supervision) Act (SISA) which expressly defines a 'standard employer sponsored member'.

6 The Hon. Bill Shorten, Press Release, 29 August 2011, Future of Financial Advice Reforms – Draft Legislation

Exception from ban for 'individual' superannuation policies

MLC believes there is an unintended dissonance between the Minister's intended policy for 'Group' and 'Individual' insurance policies. Based on the Minister's announcement, we understood that the policy intention was to ban commission on superannuation insurance policies purchased for 'groups' of members as opposed to those purchased by individuals. Thus, the intent was that where an advised individual purchased insurance inside superannuation, commission could be paid to the adviser in respect of that individually purchased insurance arrangement.

However, the precise definition of 'group life policy' at s963B(2), could result in 'individual' arrangements being captured by the ban. It should be noted that the terms 'group insurance' and/or 'group life policy' are not explicitly defined in law. Thus, while they typically refer to an arrangement purchased for a group of persons (such as an employer group or an industry association), they may also refer to arrangements entered into with superannuation trustees which enable access for individual members to insurance benefits. For example, group life policies (or master policies) may be issued to the trustee for an individual member in the Fund.

Consequently, the reference in s963B(2) "for the benefit of a class or members of the entity" could potentially result in individual insurance arrangements being inadvertently captured by the ban on group insurance arrangements. This is because individual members may be identified as being part of a class of members in the superannuation trust governing rules or being a part of a class of members in the insurance policy itself. For example, even though the individual member has received individual advice on the insurance policy, this may be inadvertently caught under the group life policy definition.

MLC is concerned that the reference to 'group life policy' and 'benefit of a class of members' creates uncertainty and unintentionally widens the scope of the ban to capture individually advised members. A more effective approach may be to set the criteria for the exception to the commission ban by reference to the end result of the arrangement rather than how the arrangement is structured and for this to be made explicit in the final legislation/regulation.

To ensure that the ban on benefits to Licensees in relation to a group life policy for members of a superannuation entity does not capture individual advice arrangements, section 963B(2) might be qualified as follows (possibly as a new section 963B(2A)):

An insurance arrangement within a group life policy:

(a) that is an insurance interest issued in respect of an individual member at the request of that individual member; and

(b) that insurance interest is not part of or an increase to a benefit to the member referred to in 963B(3)(b),

is deemed not to be a group life policy for members of a superannuation entity for the purposes of section 963B(1).

The intention of this suggested draft provision is to ensure that the ban does not include insurance interests which are, or are in essence, a 'Choice' product.

Other significant reforms

MLC would also like to draw the Committee's attention to the other significant reforms being introduced which will also require the industry to devote significant resources to ensure compliance. These include: Basel III; G-20 reforms; Stronger Super reforms; Consumer Credit reforms; Managed Investment Trust regime; banking competition reforms; insurance capital regime changes; tax agent service reforms; personal property securities law; and the US Foreign Account Tax Compliance Law (FATCA).

Conclusion

MLC is appreciative of the opportunity to participate in this inquiry of the Parliamentary Joint Committee on Corporations and Financial Services. We put forward the document for your consideration.

Appendix: MLC Position on Conflicted Remuneration

It has long been MLC's view that the industry should be encouraged and assisted in moving to remuneration models that reflect the interests of the client in preference to the product provider or adviser. As a consequence, we believe trust in the industry will improve and hence Australians are more likely to experience the benefits of financial advice.

MLC believes the proposed banning of Volume Based Incentives (VBIs) will have multiple benefits for the industry and for the consumer. The industry will become less conflicted, more transparent and clearer, leading to improved trust from consumers. Product providers will have to compete on features, service and price, as well as explicitly disclosing the entity from which products are being sourced and this will deliver a better outcome for consumers.

Historically, sales and commission structures were critical in the delivery of products to clients. Over the past 20 plus years, the investment landscape has changed dramatically in terms of the legislative environment and also product sophistication, resulting in more choice, flexibility and complexity.

This increase in complexity only serves to highlight the importance of having a professional financial advice industry. In this context, product providers are central in assisting the industry rise to this challenge.

"It is absolutely crucial to the integrity of the advice industry—or any industry involving a high degree of trust and responsibility—that the consumer can be confident that the adviser is working for them. It is only by ensuring that advisers' only source of income is from their clients that clients can be sure that the adviser is working for the client, rather than a product provider."[7] - The Hon. Bill Shorten

MLC argues that some remuneration models are simply another way to package up remuneration flows that provide the same economic outcomes in a different guise. Our understanding of the policy is that advice should not be conflicted by the remuneration payments from product providers. Instead, advice should be paid by, and provided to, a client in a transparent manner.

7 The Hon. Bill Shorten – Second Reading Speech, 24 November 2011

The original FoFA package states that the proposed reforms should *"provide transparency for consumers in regard to adviser charging."*[8]

The notion of transparency is now regarded as a fundamental principle in the design and promotion of financial service products. It supports a key aim of sound regulation, that is, to address and rebalance instances of information asymmetry between services providers and clients.

In MLC's view, a lack of transparency can lead to models that dilute the relationship between financial advisers and clients, and undermine the aim of creating a professional financial planning industry.

White labelling

MLC generally believes that white labelling is conflicted because the product provider is effectively paying a revenue margin to the licensee (that provides advice to retail clients).

Based on our understanding of current white label arrangements, a product provider supplies a product at a particular price (which may be discounted to their own market price in anticipation of greater volumes) to a licensee. The proprietary branding of the product provider is replaced by the licensee's brand and a margin is added to the product provider's fees. The licensee generally makes no additions to the features or services provided by the product provider (but there can be exclusions).

A white label therefore, is simply another way to pass on volume payments from a product provider to a licensee, as the licensee essentially becomes a distributor for the product provider.

Currently, it is our view that white label structures in the managed investment and superannuation market are not clear and can compromise interactions between market participants.

Lowering the back end of administration costs (one of the main arguments used to support white labelling) to counter volume bonuses will only further distort the relationship between the financial adviser and the client. This is because the saving is not attributed to the client but used to boost the financial adviser's remuneration.

8 P8, The Future of Financial Advice Information Pack, Monday 26 April 2010

Private label

Private labelling is akin to a vertically integrated business model where the licensee (or related body corporate) is the regulated product provider (albeit with outsourced administration if needed) required to meet all the necessary standards under the law.

Unlike a white label, a private label is not simply a 'cover' allowing an increased payment to a financial adviser. Private labels effectively give access to wholesale pricing for clients but it is very clear to the client that they are contracting with the licensee as product provider.

Likewise, the licensee (or related body corporate) takes on the licensing obligations, capital requirements, legislative and legal responsibilities and risks of being a product provider. Therefore, in this model there is a level of governance and commitment that is (entirely appropriately) imposed upon the licensee/product provider, which does not apply in a white label arrangement.

In particular, MLC believes that capital requirements for the Responsible Entity (RE) deliver a range of important outcomes including:

- Fortifying the entity and its obligations in the event of operational or governance failure;
- Providing fund members and the wider market with the evidence of the trustee's bona fides and commitment to fund members; and
- Ensuring that trustees/REs prudently manage the fund while a mandated amount of money or liability remains '*at-risk*'.

In essence, the RE is participating in the value which it has created.

Operator

MLC is concerned with the lexicon used in the financial services industry especially in regard to platforms which involve volume based incentive arrangements. Historically, there has been a term used as 'co-operator'. This term has been replaced with 'operator' or 'promoter'. MLC believes this has (and may be) potentially used to obfuscate issues around the Government's stated FoFA policy and hide conflicted adviser remuneration.

The use of the term promoter/operator is non-transparent and allows fees to be kept hidden and not transparent to the end client. Each promoter (which may or may not be a licensee in its own right) can have a different deal which provides remuneration with the administrator into which the end client has no line of sight.

It has been argued by the 'promoter' that they are the real issuer of the arrangement and the agreement they have in place is purely an outsource function as they 'promote' the service. MLC argues that while outsourcing services such as administration and investment management is appropriate, it cannot be justified to outsource the RE role which in effect what these arrangements do. As mentioned above, MLC believes that if the Licensee wishes to enter into these arrangements it is vital that the Licensee (or related body corporate) is the RE, who will carry the legislative responsibilities of being a product provider.

The benefits of this consumer oriented approach include:

- The industry will be less conflicted and more easily trusted by clients;
- The various players in the industry will have the roles and responsibilities that are consistent with the client facing product branding which improves the transparency of the system in the eyes of clients;
- Product providers have to compete on features, service and price; delivering a better outcome for clients; and
- These changes encourage the industry to move towards less conflicted remuneration models that are more consistent with the best interest duty obligations.