Corporations Amendment (Further Future of Financial Advice) Bill 2011 and Explanatory Memorandum

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ANZ Submission to the
Parliamentary Joint Committee on
Corporations and Financial Services

ANZ

1. Executive Summary

ANZ is pleased to make a submission on the Corporations Amendment (Further Future of Financial Advice) Bill 2011, referred to in this submission as tranche two legislation, and its related explanatory memorandum (EM). This builds on our previous submission to the Committee's inquiry into the Corporations (Future of Financial Advice) Bill (the tranche one legislation) and explanatory memorandum.

ANZ's comments on the draft legislation and EM are predominantly limited to the policy objectives and outcomes of the bill and EM. In relation to more specific commentary on technical drafting issues, particularly on the formulation of the best interest duty, we support the Financial Services Council (FSC) submission that addresses these matters.

As mentioned in our previous submission to this inquiry, ANZ supports the Government's underlying objective of the Future of Financial Advice (FoFA) reforms to improve the quality of financial advice while building trust and confidence in the financial planning industry. We also support the focus on facilitating access to financial advice.

Notwithstanding our support for this objective, we have the following concerns the tranche two legislation and EM. We have made a number of recommendations in the submission which address these issues.

- Will unduly inhibit the distribution of a significant number of financial products by banks including products such as simple and low cost superannuation and investment products despite the fact that banks:
    - have strict controls in place by adopting the balanced scorecard approach to remunerate good staff performance; and
    - are subject to APRA standards as approved deposit-taking institutions;

- Does not include general advice as a carve-out from the ban on conflicted remuneration particularly in situations where the advice meets the conditions of being provided for free and, in relation to superannuation and investments products, there is no commission charged;

- Will increase complexity in bank remuneration schemes. Any prohibition on incentives provided for basic banking product sales where those sales are also made in conjunction with advice being given on other financial products will introduce complexity to the bank remuneration environment and will be extremely difficult to monitor and track. This in turn will lead to confusion as to whether an employee of an Authorised Deposit-taking Institution (ADI) is eligible for an incentive sales bonus related to a basic banking product under a variety of different scenarios;

- Is not clear on how the ban on conflicted remuneration will apply to Consumer Credit Insurance. We believe it should be treated, for the purposes of the bill, as a general insurance product;

- Is not clear whether the Execution-Only (non-advice) services carve out from the ban on conflicted remuneration also applies to the stockbroking environment. Further discussions are required between industry and Government to settle the precise nature of the carve-out for stockbroking from the ban on conflicted remuneration;

We note the Minister indicated in his second reading speech on the tranche two bill that commission arrangements in force prior to 1 July 2012 can be grandfathered. However, we do not believe that the bill, as currently drafted, delivers that outcome.

2. The application of the best interest duty and the ban on conflicted remuneration to certain wealth and banking products

The Government's Future of Financial Advice package provides a limited carve-out from the ban on volume payments and the best interest duty for basic banking products. This would apply where employees of an Australian Deposit-taking Institution (ADI) are advising on and selling their employer ADI basic banking products.

In addition, it provides a limited carve out for:

- General insurance;
- Life insurance that is not bundled with a superannuation product;
- Individual life policies which are not connected with a default superannuation fund; and
- Execution-only (non-advice) services.

ANZ is concerned that the limited carve outs above will impact customer accessibility to a significant number of financial products by banks including products such as simple and low cost superannuation and investment products from their local bank branch.

Many people go to their bank for trusted advice on a wide range of banking, wealth and protection needs and especially for financial advice. Banks are easily accessible, and provide services in many diverse and remote regional areas.

3. Australian Prudential Regulation Authority (APRA) Regulation of ADI Remuneration Policies

The remuneration policies of ADIs, which are underpinned by APRA's Prudential Standard APS510, Governance, Prudential Standard GPS 510, Governance and Prudential Standard LPS 510 Governance and its Prudential Practice Guide PPG511, are deliberately framed to ensure the avoidance of inappropriate risk.

The distribution of financial products by ADIs is generally limited to:

- Employees who do not provide personal advice (that is, they can only provide general advice or factual information) unless they are bank-based financial advisers or specialists that are licensed and appropriately authorised to also provide personal advice;
- Employees who have received specific product accreditation training on certain products that they are accredited by their employer to sell;
- Employees or contractors (e.g. telesales bureaus) who are only permitted to distribute products issued by their employer ADI (or related body corporate).

As an ADI and an AFSL holder, ANZ complies with APRA's and ASIC's requirements to ensure we have appropriate policies in place to manage conflicts of interest and to ensure that our representatives are adequately trained,

competent, supervised and monitored. There are strong inter-dependencies between ANZ's risk management framework and remuneration practices.

ANZ believes that risks associated with the distribution of financial products by banks are best managed under the existing risk management frameworks that have been developed as a consequence of APRA guidance and standards and in order to meet licensing requirements under the AFSL regime.

Further we support the FSC's submission that the definition of conflicted remuneration should not extend to general advice that is available to the public at large since this form of advice is far less likely to influence the decision of a retail client compared with personal advice that is provided with the benefit of a full customer fact find.

Recommendation A: ANZ recommends that the second tranche legislation be amended to classify certain benefits given by an employer to an employee or contractor relating to the recommendation of any financial product as not being conflicted remuneration if the employee or contractor is only Tier 2 Accredited and the ADI can demonstrate that its risk and remuneration policies respond to the relevant APRA standards and guidance on remuneration. That is, existing APRA Prudential Standards provide adequate safeguards in respect of Tier 2 Accredited employees and contractors of banks, who are also subject to ASIC Regulatory Guide, and should therefore be carved out.

4. Employee performance metrics are set against several indicators

Remuneration arrangements for frontline banking staff rewards out-performance while ensuring avoidance of inappropriate risk. This is done by utilising a balanced scorecard framework, aligned to role specialisation and capability, customer satisfaction and advocacy and a strong compliance management framework that includes risk gateways and where necessary reduction of or ineligibility for incentives for inappropriate behaviour. Even if an employee out-performs in relation to their financial metric, where value or volume based targets are used, they can still fall short of receiving an incentive payment if they have not met their other non financial performance objectives.

ANZ believes that, viewed in conjunction with APRA regulation of bank remuneration which does not apply to other industry sectors, the balanced scorecard approach to incentivising staff provides appropriate safeguards against the mis-selling of products by bank employees.

Recommendation B: ANZ recommends that where banks utilize a balanced scorecard approach to incentivising staff that this should not be deemed conflicted remuneration. Consequently we recommend that example 2.2 of the tranche two EM is deleted.

5. Establishing a general advice carve out from the ban on conflicted remuneration

The legislation includes a carve-out from the ban on conflicted remuneration for product sales that occur on an execution-only (non-advice) basis.

ANZ is a strong proponent of financial advice and believes that we should maximise opportunities to provide low or no cost financial advice to consumers to assist them in making choices about their financial affairs.

General advice can be a very important tool in helping customers to understand financial products or trigger them to consider a more detailed examination through personal financial advice. In this regard general advice can be an important gateway to customers taking greater control of their financial future.

Recommendation C: ANZ recommends that incentive payments related to the provision of general advice on financial products should not be considered as conflicted remuneration under the second tranche legislation if the advice is applied under the following conditions:

- The general advice is provided free of charge; and
- In circumstances where the general advice relates to a superannuation or investment product, no commissions are attached to the product.

ANZ believes the conditions as outlined in recommendations A, B and C will ensure that customers are not placed into products for which they may not be suitable primarily based on inappropriate incentives for advisers or bank employees.

6. Issues with the application of the best interest duty and the ban on conflicted remuneration to certain wealth, protection and banking products

The FoFA Information Pack dated 28 April 2011 recognises that certain basic banking products will be carved-out from the ban on conflicted remuneration (section 2.8). The rationale for the basic banking products carve-out is noted as:

- Compliance burden of the new requirements;
- Significant changes to employee remuneration and workplace arrangements;
- Applying where there is not the same level of conflict and risk and in respect of products that have not been implicated in causing severe consumer detriment as a result of inappropriate selling, i.e. products that are easier for consumers to understand;
- Applying to frontline staff (e.g. tellers and specialists) of ADIs advising on products of the ADI. In this situation consumers will more readily understand that the frontline employee of the ADI is in the business of selling the employer's product.

The carve-out recognises that banks play an important role as a one stop shop for the community's banking, wealth and protection needs.

ANZ believes the framing of the basic banking carve-out and how it relates to other conflicted and non conflicted remuneration arrangements for other financial products/advice will introduce new complexity to remuneration arrangements and presents the following issues:

- In the EM the Government appears to recognise the balanced scorecard approach as an acceptable remuneration arrangement when it states at 2.19:

  > "If an employees is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to the volume is presumed to be conflicted. However, *if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of*

the financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned".

We are concerned that the subjective test of the EM's wording (in italics above) will require an overly cautious approach to the setting of remuneration arrangements for their employees. This will in effect prevent them from effectively distributing non basic banking products that are entirely appropriate for their customers because banks are unable to incentivise staff to recommend these products.

Greater clarity is required in the EM and bill so that banks and their employees can work within a single, consistent approach to remuneration across all bank and wealth products.

- Notwithstanding the guidance provided as to whether remuneration is conflicted or not, the use of the term "solely" at 961B (3) (a), 963B (1) (a) (b), 963 C (a) and 963 D (b) has the effect of diluting any appropriate relief or carve outs from the ban on conflicted remuneration or the best interest duty. Example 2.2 of the EM also works at cross purposes with the proposed guidance on what is conflicted remuneration.

  The effect of these provisions is that the bill prohibits the incentivisation of staff for recommending basic banking products in circumstances where they are also giving other financial product advice that does not relate to a basic banking product, even in situations where the best interest duty requires the consideration of more than one product. From a compliance perspective this introduces significant complexity and will be extremely difficult to monitor and track. Moreover, there is the increased possibility of detrimental customer outcome in that they may not be offered products that they require.

  Even if a technical solution can be found, the practical application of this provision remains problematic, as outlined by the following example. If a bank employee is in the process of opening a transaction account for a customer and uncovers a need for building insurance to protect against natural disaster, the bank employee may need to refer the customer to a different member of staff to deal with the insurance matter. This would be required in order to preserve the "non conflicted remuneration" treatment of the basic banking product transaction. ANZ has a number of smaller branch sites where there would not be a different staff member to deal with the insurance matter.

Recommendation D: ANZ recommends that greater clarity is given in the bill and EM so that banks and their employees can operate under a single and consistent remuneration policy that aligns with the best interest duty and allows any other potential customer needs to be met (such as that described under recommendation A, B and C). In addition we recommend the term "solely" at 961B (3) (a), 963B (1) (a) (b), 963 C (a) and 963 D (b) be deleted.

7. Carve-out required for other financial products deemed to be lower risk

We also note Section 961F defines a basic banking product as a basic deposit product or non cash payment facility relating to a basic deposit product, a first home saver account, a travellers' cheque facility and other products prescribed by regulation.

The EM at 1.49 states that the regulation making power "provides flexibility to add additional products in the future if it is considered appropriate for them to fall within this arrangement given the constant rate of development in the financial product market."

We consider that a carve-out to other financial products that may be deemed to be lower risk would also be appropriate. Providing access to these products through bank branches will increase consumer access to simple wealth products and diversification – the most basic wealth protection strategy. If this is not the case consumers who cannot afford personal financial advice may not be able to access these products.

An example of such a product would be a simple superannuation product as defined in the Government's draft Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011. There are already products on the market that would be deemed to have comparable features to the MySuper product outlined in the core provisions bill.

In the absence of Government embracing carve-outs from the ban on conflicted remuneration based on the recommendations above, we would suggest that the second tranche' legislation or regulations move to accommodate a greater carve-out of simple wealth and protection products.

This, however, is not our favoured course of action due to complexity that could arise from having to amend the legislation or regulations to accommodate numerous products that exist across the banking industry.

Recommendation E: If Government does not accept recommendations A, B or C (above), ANZ recommends that Government work with banks to identify financial products or classes of financial products that would be suitable in terms of their risk to customers to be carved out from the ban on conflicted remuneration. For example MySuper products, and other superannuation products that are comparable to MySuper products that exist prior to the MySuper start date of 1 July 2013, should be carved out from the ban on conflicted remuneration.

8. Clarification of the carve out from the ban on conflicted remuneration as it applies to Consumer Credit Insurance (CCI) Products

As noted above, the Government has provided a carve-out from the ban on conflicted remuneration for general insurance, life insurance that is not bundled with a superannuation product, and individual life policies which are not connected with a default superannuation fund.

CCI is a combination of life and general insurance under one insurance contract. Typically, it is jointly issued by a life company and a general insurer. It is not clear how CCI insurance fits in with the proposed exemptions. For example, under the current provision dealing with non-monetary benefits, CCI could be caught given that life insurance is not exempt.

Further clarity is required on whether CCI is to be treated as a general insurance product or life insurance product. Our preference would be that it be treated as a general insurance product.

Recommendation F: For the purposes of interpreting the carve-outs from conflicted remuneration as they apply to general and life insurance products, ANZ recommends that CCI insurance be defined as being a general insurance product

9. Clarification of the carve out from the ban on conflicted remuneration as it applies to stockbroking

ANZ welcomes the proposed carve out for execution-only (non-advice) services from the ban on conflicted remuneration with respect to both monetary and non-monetary (soft dollar) benefits. This is sensible because execution-only services exist to help satisfy customer driven needs and occurs in the absence of the provision of any financial or investment advice.

We also note that the EM refers to a carve-out that will be provided to exclude certain stockbroking activities from being considered conflicted remuneration, with "the precise breadth of the carve-out [being] subject to further consultation".

In particular "the receipt of stamping fees from companies for capital-raising on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market" is mentioned.

Recommendation G: For absolute clarity on the scale of the carve-out from conflicted remuneration as it applies to stockbroking ANZ recommends that:

- The EM and draft bill make clear that the carve out for execution-only (non-advice) services applies equally to stockbroking activities (whether direct to customers or intermediated); and
- Treasury develop with industry a comprehensive list of what specific stockbroking activities are considered capital-raising and are thus exempted.

E*TRADE also has white labelling arrangements in place with a range of businesses to provide services that leverage E*TRADE's platform. E*TRADE has two existing service offerings in relation to white labelling. The first one is the provision of white label services to other financial institutions and the second one with intermediaries that are licensed AFSL holders, both for the provision of 'execution only' stockbroking services. All white label arrangements are governed by commercially negotiated contracts with the white label provider and are purely a transactional service.

Recommendation H: ANZ supports the ABA's previous submission to Government that prohibiting business-to-business payments that relate to the distribution of products and/or services via white labelling arrangements is unnecessary. These arrangements do not inherently create the circumstance of 'biased advice' and a prohibition may create unintended consequences such as services being withdrawn.

10. Ensuring advisers that provide individualised advice on life insurance are appropriately remunerated

ANZ believes that the ban on life insurance commissions in super should be limited to default fund arrangements.

The current ban captures all group life policies, irrespective of whether a member has obtained financial advice. This creates an inconsistency in the application of Government policy. The blanket ban on all group insurance policies does not take into consideration that tailored cover subject to individual financial advice can be provided under group policy arrangements. In these circumstances, the use of a group insurance policy merely reflects the structural arrangement for the efficient delivery of insurance to members of a superannuation fund. The fact that a member has chosen to obtain cover through a group policy as opposed to an

individual contract does not signify that that the member was not the beneficiary of financial advice. That is, it is not an indicator of whether or not a member has received individualised advice and elected to make choices about their insurance cover.

For this reason, the above would appear to run counter to the policy intent of the Minister who indicated at the FSC's Annual Conference on 4 August 2011 that he was more persuaded by the argument against the proposed commissions ban in certain cases such as where there has been work by an adviser that had gone into acquiring the product on behalf of an individual.

ANZ believes the FSC's proposed remedy on this issue is more in line with a policy intent that would seek to have advisers appropriately remunerated for work they undertake in advising an individual on their life insurance needs.

Recommendation I: ANZ recommends that sections 963B(b)(i) and 963B(2) should be deleted and therefore carved-out from the concept of conflicted remuneration.

11. Grandfathering

The FoFA bills and related regulations will result in significant changes to existing advice businesses and, as a result, the reform package could impact on the ability of advisers to provide service and advice to their clients. The Minister acknowledged this in his second reading speech by indicating that existing trail commission books will be 'grandfathered'.

We are concerned that section 1528 (1) (b) has the effect of retrospectively banning commission payments entered into prior to 1 July 2012 since the reference in the section the grandfathering not applying when "the benefit is not given by a platform operator" could be construed as applying to situations where a fund manager (that operates a platform) makes commission payments to financial planners or licensees.

Recommendation J: In light of the significant disruption that the FoFA reforms will create for existing advice businesses, ANZ recommends the grandfathering of all (non workplace related) contractual arrangements in place prior to the commencement date for the FoFA reforms. This can be achieved by deleting section 1528 (1) (b) of the bill.