Associated
Advisory
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Parliamentary Joint Committee on Corporations and Financial Services

Corporations Amendment (Future of Financial Advice) Bill 2011

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AAP would like to thank the PJC for the opportunity to provide further submissions on the inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

As previously stated AAP provides compliance and business development services to its members which currently stand at over 170 independently owned Australian Financial Service Licence holders. On behalf of our members we would like to express our concerns that many of the decision makers with whom we have spoken to do not have a full appreciation of the impact of the reforms on independently owned financial planning practices, the impact on competition, and the clients of all financial planners.

The overall theme of the concern our members have in relation to the FoFA reforms can be summarised below:

A lack of proper consultation

- We feel there has been a lack of proper consultation with the independently owned arm of the industry resulting in legislation that will impact on competition, increase operational and compliance costs and make financial advice less affordable to many people. We will expand on these claims below.

Banning of volume rebates will produce an anti-competitive market

- AAP believes that the proposal to ban volume rebates in its current form will result in an anti-competitive market. This is an area that requires careful consideration as the very likely consequences are that competitive advantages will be enjoyed by the leading banks and large institutions while having a hugely negative impact on smaller players.

- Banks and institutions operate vertically integrated business models therefore have considerable scale and distribution advantages, and the advent of FoFA will see an expansion of these advantages. While views on the impact of these proposals diverge, the reality for independents, boutiques and smaller dealer groups is that these measures will increase the cost of providing financial advice and reduce their capacity to operate profitable planning practices – at least on a level footing with the large players.

Vertical integration and competition in the industry

- The reforms are an attack on small business as they will have a more severe effect on independently owned small business as opposed to larger institutions that have the benefit of vertical integration.

- It is well known in the financial services industry that large product providers could not charge for financial advice and still make a profit based on the revenue generated by the products they own. These reforms will put more pressure on independently owned financial planning practices, who (as a result of FoFA) will have to compete with product providers with increased market power, who can provide advice at or below cost which may raise issues under part IV of the *Competition and Consumer Act* 2010.

- We are concerned that the government has not had proper regard to the overall impact on competition. In our view this issue has either been deliberately overlooked or there has been a complete failure by the government to fully appreciate the overall impact on competition. In our previous submission to the PJC we referred to a letter from the Office of the Hon Wayne Swan who indicated that it would be too difficult to stop vertical integration. This was very disappointing for independently owned financial planners who are arguably at the least risk of providing conflicted advice.

Anti-competitive markets will result in anti-competitive practices

- Smaller independents and boutiques just don't have the same resources and financial capacity to compete and may eventually be pushed to join larger groups, or out of the industry altogether. This is detrimental to competition and consumers because it allows the remaining large and powerful firms in those markets to exercise pricing power to push up prices at will. Australia has already seen the impacts of these powers, with the big four banks having control over the passing on of interest rate cuts.

- According to the ACCC, "Part IV of the *Competition and Consumer Act 2010* (the Act) prohibits various anti-competitive practices that limit or prevent competition. It aims to foster the competitive environment necessary to give consumers diversity of choice in price, quality and service for goods and services. For example, Part IV prohibits specified cartel conduct and other forms of conduct among competitors that substantially lessens competition in a market. A reduction in competition that may occur as a result of the collusion might allow some traders to push prices up and lower the quality of the goods and services they offer to consumers."

Anti-competitive reforms will be detrimental to consumers

- It should be emphasised that whilst we support the reforms to the extent that it aims to improve the trust and confidence of Australian retail investors in the financial planning sector, we are concerned that the uneven playing field under its proposed delivery will not only push many small players out, but may also result in pricing an important consumer segment out of the market- and it will ultimately be consumers who will suffer.

- The impact of this anti-competitive proposal will produce an industry where vertically integrated players predominate, resulting in less competition, and decreased choice and access to financial advice for consumers.

- From a client share perspective, institutions, banks and industry funds will likely end up with the biggest slice- picking up the majority of average Australians, who have an apathetic view on the provision of advice. At the other end of the scale, for boutiques and independents that *are* able to survive (and in order to continue operating), it may be economically viable to only service high net worth clients (factoring in increased compliance costs, and higher demands on time and resources in meeting the requirements under FoFA).

- Therefore, it is middle Australia- those who earn a slightly higher than average income, and are active in managing their finances - who will be left in no man's land. As it currently stands, every Australian is able to source financial advice, but this may not be the case going forward.

Opt-in and annual fee disclosure

- If no changes are made to the FoFA Bill in its current form not only will independently owned financial planning practices be competing on an uneven playing field, but they will also be required to comply with the requirements of Opt-in which includes providing an annual fee disclosure statement.

- Neither AAP, nor our members understand the necessity or rationale behind the requirement of an annual fee disclosure statement when this information is contained within disclosure documents and statements provided by products providers. An annual fee disclosure statement is effectively double handling.

- The introduction of an annual fee disclosure statement was included in the release of the first tranche of the FoFA Bill. It was disappointing there was no consultation process prior to the inclusion of the annual fee disclosure statement in the first tranche of the FoFA Bill. The government deprived the industry of the opportunity to consider and provide submissions regarding the annual fee disclosure statement in conjunction with the proposed Opt-in requirement, rather than in isolation.

There are a number of concerns in relation to the requirement to provide an annual fee disclosure in addition to having a client Opt-in:

- There is still a lack of clarity in respect to which type of clients (e.g. risk, investment or combination) the legislation will apply. There is also a lack of clarity around the meaning of the types of excluded 'commission' type payments and what is considered an 'on-going fee'? For example are platform fees or legacy fund fees captured by the legislation?

- It is unclear how the obligation to disclose the actual amount of the fees to paid by the client in the preceding 12 months will be able to be discharged given the annual fee disclosure must be provided 30 days prior to the relevant disclosure date. Where ongoing fees are dependent on variable factors (e.g. a percentage of assets under management as at the end of a period). The same also applies in respect of the next 12 months; this will only be able to be an approximation. It is our view that this requirement will be unworkable.

- The financial cost as well as the time required to provide annual disclosure statements have not been properly considered by the government and this will be a very costly exercise for financial planners. At present it is an unknown how many financial planning practices will provide annual fee disclosure statements however it is likely many will have to adopt new technology.

- Exactly how technology providers will offer such services is still unknown. Nevertheless, it is expected that in many respects the various technology providers will need to enhance their systems to provide this capability. In essence there are two issues here:

  a) the fast approaching date of 1 July 2012 for implementation of FoFA which leaves little or no time for financial planners to prepare, implement software, train staff, etc.; and

  b) an additional cost to financial planners that don't currently have a system that would be capable in the future to provide such a function.

- The Opt-in requirements do not apply to any other industry and AAP has previously stated that Opt-in has the potential to leave clients vulnerable at a time when they require financial advice. Given Opt-in was not a recommendation of the Ripoll Enquiry we cannot comprehend why the government would continue down this path of reform and not examine alternative strategies.

- The cost of implementing annual fee disclosure will be an unnecessary burden for the industry with the costs either having to be absorbed by the licensee or passed onto the client. It is AAP's view that if the annual fee disclosure requirement is implemented less people will have access to quality financial advice yet the government has stated that one of the challenges of FoFA is to ensure more Australians have access to high quality and affordable advice. We believe that the spirit of the legislation and the government's stated aims are incongruous.

Opt-In (two yearly renewal)

Opt-In, requires the financial planner to give new clients as of the 1 July 2012, a renewal notice every two years (along with an annual fee disclosure statement) which includes:

- The client renew the ongoing fee arrangement by written notice;

- The ongoing fee arrangement will terminate, and no further advice will be provided or fee charged if the client does not renew the arrangement; and

- The client will be taken to have elected not to renew the arrangement if they do not give the financial planner a written renewal notice.

The issues around the Opt-in requirement are numerous in relation to a client not renewing and include:

- Electing to opt-out at a time that they most need an financial planner;

- Disregarding important communications from the financial planner;

- Unintentionally not opting in because (a) they are away (b) could be unwell, and the list can go on and on;

- The increased possibility of claims against financial planners by clients who forgot to Opt-in, followed by a market 'incidence' and the assumption that their financial planner would look after

their investment portfolio because their financial planner would know that they wouldn't terminate the relationship.

There are two other points, and this is in respect to our opinion that the Opt-in should not be legislated:

- Part of the FoFA reforms requires a financial planner to act in a client's best interest. A financial planner who acts in a client's best interest is not going to do anything that would put their own interests ahead of those of the client.

- Part of the requirement of the annual fee disclosure is an inclusion that the client can Opt-out. Surely it is an administrative overkill to require a financial planner to have a client Opt-in every two years combined with disclosure notifying a client that they can opt-out.

Best interest obligations

- The requirement that financial advice must be in the best interests of clients is at the heart of the FoFA reforms and has been universally embraced by the industry. AAP supports the requirement for advisers to place the best interests of their clients ahead of their own, in positively increasing consumer confidence and solidifying trust in financial advisers.

- However we wish to bring to attention two main points which we believe are not conducive to this intent. Firstly, reforms which result in anti-competitiveness in the financial advice industry as mentioned earlier, will risk the fundamental provision of true arms-length advice to consumers across a broad array of financial products and services.

- Diminishment of independently-owned licensees will equate to a market dominated by bank owned dealer groups and bank advising arms, which are essentially advisers selling product on behalf of institutionally-owned networks rather than advisers necessarily acting in the best interests of consumers.

- If the argument will be that these activities may be justifiable as long as they fit within the prescribed best interests steps, we then ask why the same logic is not applied to advisers at independently-owned licensees being able to exercise fiduciary judgement without the need for such wide-sweeping banning of what has been termed 'conflicted remuneration'?

- Secondly, we would like to address our concerns regarding the best interest steps in particular, subsection 961B (1)(g) which prescribes that the "provider" must have "taken any other step that would be reasonably regarded as being in the best interests of the client, given the client's circumstances." The ambiguity of this requirement will leave a hole for legal liabilities.

- We have expressed in our discussions with the Government and Treasury that the best interest duties must be drafted in clear and simple terms. Without a clear and objective measure to test whether an adviser has acted in the best interest of their client, advisers will be exposed to significant risk, pushing up the cost of Professional Indemnity Insurance, and subsequently, the cost of advice.

Transitional provisions excluding volume payments from platforms

- Whilst we do not support the banning of volume payments, we believe that the transitional provisions at the very least should include consistent carve outs. The transitional provisions to our understanding, not only allow for gradual change to the new reforms, but also provide for the honouring of contractual obligations already in existence prior to the date that the new requirements commence. For these reasons, we welcome the carve-out for existing contracts which relate to commissions. However, it seems contradictory then, for the carve outs to exclude payments from platform operators.

- The payments made by superannuation and wrap service operators and providers to dealer groups are made for various purposes including the funding of administration and distribution services. Those services are provided to consumers which effectively allow them to access a choice of investment options through a portal, which is known in the industry as a platform.

  The contracts in existence between platforms and licensees (or its authorised representatives) grant them property rights over the payments made by platforms. Therefore, a revisit of the proposed 1528 (1)(b) and (2)(b) of the Bill in seeking to ban these payments, by necessity must take into consideration this property in the framing of the law. Additionally, clarification is required at subsection 1530 which states "Regulations do not apply where an acquisition of property otherwise than on just terms would result."

Inadequate time to prepare

- Recently it was reported that if FoFA was implemented by 1 July 2012 ASIC would be willing to take a softer approach for the first 12 months on financial planning practices who contravene the new reforms, if the contravention was a genuine mistake. It was reported that ASIC acknowledged the difficulties that financial planning practices would face given the short amount of time available to get ready for the FoFA reforms.

- If ASIC is considering a soft compliance approach in recognition of there being inadequate time to allow the industry and participants to prepare surely the government should reconsider its position and delay the implementation of FoFA. It does not provide our members any comfort that ASIC is willing to consider a softer approach. The industry requires certainty and any changes to the commencement of FoFA should be legislated.

Delay proposed 1 July 2012 commencement date

- It simply would not be possible for the industry to be compliant with the significant changes contained in these reforms by the proposed commencement date, particularly as much of the detailed requirements will be outlined in regulations which are yet to be released.

- The Bill contains a proposal that "regulations may prescribe other circumstances in which Division [4] applies, or does not apply, to a benefit given to a financial services licensee or a representative of a financial services licensee". Whilst we understand that there may be such

circumstances, and acknowledge that ASIC has indicated a “facilitative approach for the first 12 months”, it would be make more sense for the commencement date to be delayed to 2013, and instead allow proper consultation and avoid any unintended consequences of moving too quickly.

Professional development

- AAP has previously provided submissions stating that it disagrees with the requirement that professional development conferences be held in either Australia or New Zealand only. The ways that independently owned financial planning practices conduct their professional development is different from those of large financial institutions who due to their size can run courses in-house. Independently owned financial planning practices can obtain their professional development from a number of sources and it is wrong to restrict their development (or any other financial planner’s professional development) to a particular geographical area. It is better for the industry to have the availability of global resources when it comes to professional development.

Final thought

- In our view one of the problems with FoFA is that it approaches the financial planning industry as though it has the same business model as the legal or accounting industries when this is not the case. There seems to be an assumption throughout the FoFA debate that FoFA only applies to superannuation when this is not the case. Financial planning is a lifelong process which requires regular contact between the client and the financial planner and as a result a different billing process. For the reasons previously expressed we believe it is dangerous to railroad an industry into a particular billing regime or business model. It should be up to the financial planner and the client to agree how the financial planner will be remunerated for their services and not the government.

Yours sincerely

Associated Advisory Practices Ltd