FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

Mr Bernie Ripoll
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

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22 December 2011

Dear Mr Ripoll

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

The Financial Planning Association of Australia (FPA)[1] welcomes the opportunity to provide comments and feedback on both the Corporations Amendment (Future of Financial Advice) Bill 2011 & Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (ie. FOFA tranche #1 and #2).

The FPA is committed to positive legislative reform that improves consumer protections and supports the development of improved professionalism and accessible financial advice for all Australians. As such we have broadly supported the reform package since it was announced in April 2010 but we must acknowledge that we have substantial concerns with key aspects of the reform. Most notably we believe the program has not only failed to deliver on key aspects of the original goals but also exceeded the intentions of the original goals in other areas. The result is a substantial weakening of the protections that should be available to consumers and a heightened level of complexity and impracticality that will have a profound effect on the shape of the financial advice market, whilst narrowing Australian consumers access to professional financial advice.

The FPA has been a strong contributor throughout the development of the FOFA program and has previously provided many hundreds of pages of consultation feedback. The attached submission deals only with those areas where the reform has failed to deliver on its intention or areas of detail that we would like the PJC to review as part of its inquiry.

If you have any questions regarding the FPA's submission, please contact me

[1] The FPA is the peak professional body for financial planning in Australia. The 8,000 individual professional members of the FPA have an enforceable Code of Professional Practice, including the Client First principle. 5,700 of our members have achieved CFP certification, which is the global standard of excellence in financial planning. FPA practitioner members manage the financial affairs of more than 5 million Australians whose investments are valued at $630 billion.

Yours sincerely

Dante De Gori
General Manager Policy and Government Relations

FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

FOFA BILL

FPA SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE (PJC) | DATE: 22.12.2011

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

A Bill for an Act to amend the law in relation to financial products, and for related purposes

FOFA BILL TRANCHE #1 & #2

FPA submission to:

Parliamentary Joint Committee (PJC) on
Corporations and Financial Services

22 December 2011

FINANCIAL PLANNING
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FOFA BILL

FPA SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE (PJC) | DATE: 22.12.2011

TABLE OF CONTENTS

INTRODUCTION

The FPA acknowledges that the Future of Financial Advice (FOFA) reforms have been guided by two overriding principles:

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

The then Minister, the Hon Chris Bowen MP announced on 26th April 2010[2]

> *"significant reforms to the provision of financial advice, which we believe will improve the quality of advice, strengthen investor protection and underpin trust and confidence in the financial planning industry. These reforms should ultimately encourage more people to seek financial advice".*

It should also be noted that the formulation of the best interest duty was never going to be and neither should it be the avenue in which advice was going to be made more accessible and affordable. The Government had promised that this would be an outcome of FOFA but at this stage we agree with many in the profession that it is clear that Government is unlikely to meet this policy objective with the Bill as drafted. The FPA therefore submits that the FOFA reforms fail to deliver on the second guiding principle of increasing access to advice to more Australians. Indeed the official Regulatory Impact Statement (RIS) states that:

> *'it is expected that adviser remuneration, as well as the number of advisers, will reduce over the long term'*

The RIS quotes figures produced by Rice Warner that Adviser numbers will reduce from 15,400 to 8,600 in 2024[3], which the FPA submits is actually counterproductive to the proposed guiding principle and therefore FOFA, as a result, has or will partly fail in its proposed objective.

In respect to the actual reforms, the Future of Financial Advice contains three key reforms, which will apply from 1 July 2012:

1. 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;
2. The introduction of a statutory fiduciary duty for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients; and

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[2] *The Hon. Chris Bowen MP, The Future of Financial Advice, Information pack. Monday 26th April 2010, p.2.*
[3] *Explanatory Memorandum, Regulatory Impact Statement (Corporations Amendment (Future of Financial Advice Measures) Bill 2011), pp. 59-60*

3. The introduction of an adviser charging regime, which retains a range of flexible options for which consumers can pay for advice and includes a requirement for retail clients to agree to the fees and to annually renew (by opting in) to an adviser's continued services.

The FPA publicly supported the Future of Financial Advice (FOFA) reforms and was pleased that the Minister also acknowledged the role of the FPA in our commitment to ban commissions.

The FPA has been an active and constructive participant in Treasury's consultation process on the FOFA reforms as a member of the Peak Consultative Group. The proposed reforms represent the most significant change to the advice industry since the FSR and as such the FPA appreciate Treasury's approach and openness to consulting with industry and stakeholders throughout the consultation process. This approach has allowed the FPA to work in partnership with Treasury and other stakeholders to indentify practical solutions to achieving Government's objectives.

From the outset the FPA has insisted that genuine reform in Financial Advice needs to engage a far more comprehensive consideration of the entire Financial Service market place (a whole of system view). Our original submission identified that along with an encouragement to professionalism at an individual financial planner level, there should be fundamental changes to the framework of product manufacturer regulation, gatekeeper obligations and also Licensee obligations.

In approaching professional reform we believe a 'holistic' approach is required, to encompass an agenda beyond the announcements. As a result, the FPA Strategic Policy Framework - based on the Four Policy Pillars of ensuring the public interest, encouraging the development of the professional practitioner, resulting in an effective and efficient Government and regulatory environment, and alignment with the Code of Professional Practice - has shaped our approach and response to the FOFA reforms.

The FPA welcomes the overall FOFA reforms as they will play an instrumental role in improving transparency and investor protection in the financial planning industry. FPA members have led the way on professional financial planning, including adopting professional planner charging, remuneration, fiduciary obligations and professional standards.

However, it is apparent that the key objectives of 'improved transparency' and 'investor protection' can be achieved using just a few of the measures (proposed in the FOFA Bills (tranche 1 and 2). That is through the 'best interest' provisions and the 'removal of conflicted remuneration'.

The FPA do not believe the client renewal 'opt-in' measure is necessary in the new world (that will be governed by the 'best interest' measure with no commissions) and merely poses risks to the client and duplicates administration (in the case of the disclosure requirements), leading to an increase in the cost of advice for all Australians.

More specifically the areas of FOFA legislation of particular concern for the FPA include:

1. Practical implications and application of the opt-in renewal provisions (Division 3, Subdivision A, particularly s962K, s962L, s962M, s962N);

2. The doubling up of resources required for annual disclosure of fees (imposed by the application of the provisions to all clients under Division 3, Subdivision C);

3. The detail around how ASIC will apply their enhanced powers (the lack of accountability and objectivity with the provisions of the Bill);

4. The intention and detail of the Best Interest duty (Division 2, Subdivision B, particularly s961B(2) and 961E);

5. The unintended consequences of banning conflicted remuneration, such as the definition of 'group life' within superannuation [Division 4, Subdivision B, particularly s963B(2) & (3)];

6. The practical application on the banning of asset based fees on geared funds (Division 5, Subdivision B, particularly s964D); and

7. Transition and implementation of the FOFA reforms.

This paper seeks to address each of these issues by considering:

a) What is being proposed in the legislation

b) The potential issues and costs to both clients and the financial planning profession

c) The alternatives proposed by the FPA

The FPA's ultimate aim is to ensure that we protect both our profession and the clients who give us a profession. Unfortunately in a commercial environment, increased regulation and the associated costs are ultimately born by the end consumer and for this reason it is important that we ensure unnecessary measures are not introduced that duplicate existing processes, and disclosure requirements in particular, so as to ensure financial planning advice is affordable and available to all Australians and not just the very wealthy. To this end, the FPA supports the introduction of effective regulation.

The FPA acknowledges that a number of the changes we had proposed in amending the exposure draft have been recognized in the final version of the legislation. These recommendations included:

- Providing clarity in the legislation to provide for a financial planner to be rewarded on performance as was intended in the policy measure.
- Providing further detail on the stockbroker's exemption to confirm the application is available for financial planners who are eligible to provide stockbroking services.
- The removal of the term 'property' for the purposes of describing remuneration that is banned.
- Allowing for the appropriate recovery of costs associated with providing platform services with relation to the banning of volume-based shelf space fees.
- Defining what would constitute 'geared/borrowed funds' for the purpose of removing asset based fees on these amounts.

Holistic approach to the review of the FOFA Bills

The FPA has consistently stated that these reforms should not be dealt with in isolation and indeed must be considered as part of a collective agenda incorporating other refroms such as Stronger Super, Tax reform, National Consumer Credit Protection (Credit) Reform, Tax Agent Services Act (TASA) Regime and more recently the work undertaken by the Advisory Panel on Standards and Ethics. Even within the FOFA reforms there must be due consideration for the impact, intentional or otherwise, to the financial planning profession and the consequences for the clients and access to advice.

Indeed, we believe that the reform agenda does not go far enough, and the issues of product failure and corporate collapses and the roles of all players in the financial planning process should have been an integral aspect of the reform agenda. In particular the FPA is well aware of the work undertaken on this very issue by the Parliamentary Joint Committee (PJC) such as the inquiry into the collapse of Trio Capital. At a minimum, an acknowledgment is needed that financial planners do not create poor products and are not responsible for product failure or corporate collapses, however it is only the financial planner that is blamed and held financially liable.

We believe a key outcome of the FOFA reforms must be clarity around the roles of all stakeholders within the industry. We suggest consumers, media, government and even the regulator have misunderstood the complex range of causal factors leading to consumer loss in financial services and opportunities for law reform that would genuinely improve market safety and consumer protection have been lost as a consequence.

Compounding this in financial planning, is the inability of consumers to be able to identify ‘professional financial planners’ (CFP® certified) from the field of lesser qualified (RG146 only) and less professionally obligated market participants, that are also legally entitled to describe themselves as a financial planner or financial adviser. In addition, there are approximately 45,000 individuals who are authorised to provide ‘financial product advice’ in Australia. Such people include stockbrokers, insurance brokers, accountants, financial advisers, intra-fund advice call centre operators, bank tellers or fully-fledged financial planners and there is no regulatory capacity to distinguish between them. The FPA believes that financial planning is distinct from financial advice and differentiates ‘investment advice’ or other single fields of advice such as stockbroking, or life insurance from a focus on the consideration of a client’s whole financial circumstances, to plan and meet life goals. Financial planning is a process that assists the client to consider life goals and then develop financial strategies to achieve them.

To this end, the FPA is pleased that the Government has committeed to a discussion paper on restricting the term ‘Financial Planner’ and we look forward to this being released.

The reforms must also deliver a change in attitude and language, not only from the profession itself but just as importantly from Government and the Regulator. Without this the FOFA reforms will fall short of their objective to instil public trust and confidence.

The FPA acknowledges the PJC’s decision to consider FOFA Bill Tranche #1 and Tranche #2 together with one set of submissions, public hearings and one report. All the measures of the FOFA reform package interact and therefore must work correctly together to deliver effective regulation.

TRANCHE #1

THE ('OPT-IN') RENEWAL NOTICE PROVISIONS (Subdivision B)

Consistent approach to application of Bill provisions
The FPA highlights the inconsistency in the application of provisions within Division 3 – Charging ongoing fees to clients, with the client opt-in renewal provisions under Subdivision B applying only to new clients and the fee disclosure statement provisions applying to all clients. This inconsistency is exacerbated by the requirement that the fee disclosure statement must be provided with the renewal notice under the opt-in provisions in s962K and s962L(2). This inconsistency in the application of these provisions further increases the cost of implementing these measures. (See fee disclosure statement section of this submission for further details.)

Origins of proposed client renewal notice provisions[4]
The proposed reforms in FOFA tranche #1 with respect to renewal notices and disclosure statements, were not the subject of specific recommendations in the final report and recommendations of the PJC inquiry into financial products and services in Australia.

The FPA believes the Opt-in measure was introduced into the reform package to address trail commissions.

Therefore, considering that the renewal notice provisions will only apply to new clients coupled with the banning of commissions (including trail) and the introduction of a best interest duty, the FPA strongly believes that opt-in is a redundant policy.

What is being proposed in the legislation?
The legislation has proposed that a 'renewal notice' will be required to be given to clients every two years where advice arrangements are entered into for the first time on or after 1 July 2012.

A renewal notice is a statement which explains to the client that the advice arrangement will only continue where the client notifies the planner in writing within 30-days of the notice period that they wish for the arrangement to continue. The renewal notice period must be issued within 2-years from the date the arrangement was entered into or in the situation where a renewal notice has already been issued, the statement must be issued within 2-years from the date of the last renewal notice.

A standard condition of financial planning Terms of Engagement (ToE) contracts permits an ongoing fee arrangement to be terminated at any time by the client. FOFA Bill tranche #1 unnecessarily makes this law. Under the proposed legislation the contract will also be deemed to have terminated where the 'renewal notice' obligation has not been met by the financial planner or where the client has failed to respond to a

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[4] *Parliament of Australia Department of Parliamentary Services BILLS DIGEST NO. 72, 2011–12 8 November 2011 p. 8*

renewal notice (intentionally or unintentionally) within the renewal period (30 days from the day the financial planner issues a renewal notice).

Consumer impact of opt-in legislation

Potential issues for clients

The FPA have a concern as to how a financial planner can differentiate a client who actively chooses to not respond to a renewal notice against a client who's intention is to renew but for some reason does not (ie. This could be because they did not receive the renewal notice, being away on holiday, moving houses, or simply forgetting to renew).

It is unclear where the client's rights and protection end and equally when a financial planner's obligations end in these circumstances

Unfortunately, the legislation in its current form does not provide adequate protection to financial advice clients where 'the disclosure obligation' or 'renewal notice obligation' is not satisfied by the financial planner/licensee.

This is because by virtue of default the client will no longer be considered an 'advice client' if the planner does not receive the client's opt-in renewal notice within the 30 day period. This may be contrary to what the client understands and may have significant ramifications at a later date when the client attempts to seek compensation from their planner for not advising them of changes to the law and / or market movements etc that may affect their financial position / decisions.

Consumer detriment of the client opt-In renewal

- It is the ongoing relationship between financial planners and their clients that enable financial planners to immediately act, provide critical advice and reassure clients to enable them to make rational decisions during crisis situations and market uncertainty, such as during the GFC Mark I and Mark II.

- Clients who fail to Opt-In will have little recourse to licensees in the event of loss if circumstances change, such as during the extreme market uncertainty of the GFC, necessitating an adjustment to the advice given.

- Most clients receive advice under a client service agreement, which protects the client by contract terms and enables them to Opt-out at any time, however the Opt-In requirements will negate these Terms of Engagement, which are negotiated between the client and financial planner to meet the service needs of each individual client.

- The actual investment and other risks associated with managing one's financial affairs, such as breaching superannuation contribution caps, changes to legislation and changes to client's circumstances, for example, are then borne by the client alone.

- If client inertia results in a failure to opt-in, the client's investments remain in place yet the financial planner's ability to provide investment management services is stopped leaving the investments unmanaged and at risk.

- The client's advice strategy cannot be monitored or reviewed by the financial planner and could become dated and fail to meet the client's ongoing needs, which the client may not be aware of.

- The Opt-In renewal removes the ability for consumers to decide up front with their financial planner as to whether or not they wish to have a service contract for a set time period or have an annual renewal service agreement, as is current practice.

- Fails to recognise that the financial planner-client is a long-term relationship built on trust, loyalty and openness. It is not a transaction like many other financial services.

- Forcing consumers to opt-in biennially will increase the burden and unnecessary red tape for consumers.

The potential costs of the client opt-in renewal

An opt-in arrangement introduces a mandatory trigger that needs technology, processes to be changed, additional paperwork and staffing, which will lead to more cost to clients.

The Government's key policy objectives with regard to FOFA has been to increase transparency and consumer protection to the end client. Unfortunately 'opt-in' does not achieve this objective and merely poses additional administration and costs to both the financial services industry and the financial planners, costs that will ultimately be borne by the client, thereby increasing the cost of advice and reducing accessability to mainstream Australians.

In the absence of an independent Regulatory Impact Statement conducted by Treasury / Government, it appears the Government has decided to adopt research from just one stakeholder to assess the cost of the opt-in measure, which strongly suggests a flawed due diligence process was used.

Research conducted by Investment trends on behalf of the FPA has identified that one of the biggest challenges resulting from the FOFA reforms for 54% of the financial planning profession will be 'providing affordable advice' to lower balance clients. The research has also shown that the median expected cost of administering opt-in will be $133[5] per client.

The FPA believes the opt-in renewal legislation will not increase consumer protection. Rather, it will increase the cost of advice resulting in less Australians being able to access financial advice, which runs counter to the Government's stated policy objective of improving access to advice..

[5] *Investment Trends, planner technology and business model: July 2011*

The *alternatives* proposed by the FPA

The FPA proposed the following alternative arrangements to Treasury and Government throughout the two year consultation process. We request the PJC consider and adopt these valid recommendations and call for amendments to the FOFA Bill tranche #1.

Recommendation: Remove opt-in

The FPA suggests the client should have the choice to decide up front with their financial planner as to whether they wish to have a service contract for a set time period or have an annual renewal service agreement. The unfair contract provisions of the new Australian Consumer Law will ensure consumer protections are upheld.

The FPA recommends the renewal notice provisions in Subdivision B of the Bill be removed.

Alternative recommendation: Change opt-in to mandatory opt-out disclosure

Should the above recommendation not be accepted, the FPA recommends changing opt-in to opt-out. Rather than have the client reply within a certain time-frame to let the financial planner know that they wish to continue receiving advice, the client would only need to respond if they no longer wished to continue with the ongoing advice services.

To enhance the benefit of 'opt-out' and empower clients to take control of their ongoing advice relationship, mandatory opt-out disclosure should be required on all communications between the financial planner and the client. This will provide the opportunity for constant reminders and consideration of their options to continue or not with the ongoing advice services.

The benefit of this recommendation is that it removes the risk to clients of inadvertently failing to opt-in (as detailed above) and becoming non-advice clients just through complacency.

ANNUAL FEE DISCLOSURE STATEMENT

What is being proposed in the legislation?
The FOFA Bill tranche #1 legislation proposes that an annual fee disclosure statement must be provided to ***all*** retail clients (existing and new clients) who are receiving personal advice for which an ongoing fee is being charged over a period of 12 months or more. This requirement applies to both existing and new clients as at 1 July 2012 and to the situation where either the licensee or the representative of the licensee provides the advice.

An 'ongoing fee' is one where advice is provided to a retail client and a fee is charged over a period of 12 months or more. It does not include the situation where:

- the advice fee has been spread over a number of periods and the client is unable to opt-out of the arrangement; or
- the ongoing fee is purely to fund insurance premiums; or
- the fee is a 'product fee'.

The fee disclosure statement must include details of the fees charged and service provided for the last 12 months as well as an expectation of what services will be provided and fees charged in the forthcoming 12 months from the disclosure day. The current fee recipient is also required to provide information on the fees charged and service provided by any previous fee recipient within the previous 12 month period.

The disclosure day is the anniversary of the day the arrangement was entered into or where a disclosure statement has been provided, the anniversary of the day the last statement was provided.

Fee disclosure requirements already apply

"The need for appropriate disclosure" was a key Term of Reference of the 2009 PJC Inquiry into financial products and services. The PJC recommended "advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest" (Recommendation 3). However, after careful consideration the Committee did not recommend the introduction of additional fee disclosure requirements.

The existing regulatory system already includes the following fee disclosure requirements:

- current FSR legislation already requires financial planners and licensees to disclose all fees to clients;
- advice fees are included in annual statement requirements of superannuation funds and product providers;
- main disclosures include s946A (Statement of Advice) and s941A Financial Services Guide;

- the following ASIC Regulatory Guides contain obligations on financial planners in respect to the disclosure of fees:

- RG36 Licensing: Financial product advice and dealing
- RG84 Super switching advice
- RG90 Example SOA
- RG97 Enhanced fee disclosure regulations
- RG98 Licensing: Administrative action against financial service providers
- RG104 Licensing: meeting the general obligations
- RG121 Doing financial services business in Australia
- RG168 Disclosure: product disclosure statements and other disclosure obligations
- RG175 Licensing: Financial product advisers conduct and disclosure
- RG181 Licensing: managing conflicts of interest
- RG182 Dollar Disclosure
- RG200 Advise to super fund members

- FPA remuneration policy and the Code of Professional Practice, members are required to separate advice fees from product fees and are to disclose all fees to their clients.

The fee disclosure requirements of the fee disclosure statement provisions in FOFA Bill tranche #1 (Subdivision C – Disclosure for arrangements to which Subdivision B does not apply) will serve to duplicate the existing system.

History to fee disclosure provisions and Government transparency

The measure the Government proposed during its two year consultation process, including the provisions in the Exposure Draft Legislation, was to require financial planners to provide a fee disclosure statement to new clients (only) from 1 July 2012 who pay an ongoing fee.

The Government committed to the ‘prospective’ application of this measure meaning it would only apply to new clients from 1 July 2012.

The last minute introduction of *Subdivision C – Disclosure for arrangements to which Subdivision B does not apply* into FOFA Bill tranche #1 changed the fee disclosure statement provisions to apply to all clients, including existing clients. However, at no stage during the two year consultation was there discussion or consideration of the impacts and costs of this measure applying to ***all existing*** clients. As detailed in **Attachment A: *Historical overview of the development of the FOFA reforms***, Subdivision C which makes the fee disclosure statement requirements apply to all existing clients, and was introduced at the last minute into the Bill tabled into Parliament.

Further, the Regulation Impact Statement (RIS) is said to reflect the policies announced by the Government in FOFA tranche #1 and FOFA tranche #2. However, during Senate Estimates on 19 October on questioning of a Department of Treasury representative by Senator Cormann, it emerged that, among other things, subsequent changes to the proposed opt-in reforms advised in FOFA tranche #1, namely the new application of the fee disclosure provisions, had not been the subject of a RIS and were therefore ruled by the Office of Best Practice Regulation (OBPR) to be ‘non-compliant’ with the Australian Government’s own best practice regulation requirements.

More recently the Hon Bill Shorten MP[6] has publicly stated that he is listening to the issues surrounding the annual fee disclosure statement applying to ***all*** clients and is considering a possible amendment:

> *I would say this to you: that you're planners, and through some of those government MPs I mentioned and Tony Windsor and Rob Oakeshott, and of course the FPA, have made it clear to me that we need to be very careful about the form of the statement and its complexity. Simplicity is much to be preferred over some great detail, which will radically increase your costs of business. And many of you already have existing disclosure practices, which will satisfy those requirements, and we don't want you to have to reinvent the wheel. And I understand that for some planners, you've already moved beyond the debate, which we're currently having about regulation. The issue, which I'm listening very carefully to, is that perhaps we should also not make that retrospective.*
>
> *So if you've got your existing clients, they're under existing arrangements, and it should be new clients to whom that applies, and I'm listening very carefully to that. And the major reason I'm listening to it is because of the FPA and certain government and independent members who have said, "All right. If we're going to have this, let's make sure the idea works. And if we're going to get people to change some of their business model, let's not do it in such a way where it inflicts massive retrospective cost upon people who, in good faith, engaged in one business model and now are being asked to look at a new approach."*

In line with the Minister's comments, the FPA suggests that it would be inappropriate for the prescriptive fee disclosure statement provisions to be applied to ***all existing*** clients, in the absence of proper due diligence, consultation and consideration of impacts and costs involved, forcing companies (including small businesses) to change business models which were adopted under good faith.

*The potential issues and costs of application of fee disclosure statement provisions to **all exisiting** clients*

Information provided by FPA members has indicated that the average cost for annual fee disclosure statements to be given to all clients would be approximately $113[7] per client. This will represent a large percentage of the fees for smaller clients, and when it is considered that this is a duplication of disclosure requirements it seems an unnecessary cost burden for clients (as the cost will ultimately be passed on to the clients).

The application of the fee disclosure statement requirements to existing clients will:

- unnecessarily duplicate existing disclosures of advice fees which are included in annual statement requirements of superannuation funds and product providers;
- cause confusion and concern for consumers as they may believe the 'fee disclosure statement' (in addition to their annual product statement) is a 'new' fee being charged;
- require major systems changes and add significant costs to the provision of advice to consumers; and

[6] *The FPA Annual National Conference, Brisbane, 17 November 2011.*
[7] *Menico Tuck Parrish Financial Services, Jo Tuck, PJC submission, 20 December 2011, p.2*

- impact on millions of clients at a cost that has not been considered or analysed by the Government.

The provisions in s962H of the Bill are very prescriptive on the requirements of the fee disclousre statement and how and when it is to be provided to clients. To adhere to the prescriptive nature of the Bill, financial planners, licensees and product providers and superannuation funds will all be required to change existing business models, disclosure systems and processes. This presents a significant cost across the industry, particularly if the prescriptive provisions are applied to all existing clients, a cost that was not considered or analysed by Government prior to making changes to the prescriptive measures to apply to all clients and introducing the Bill into Parliament.

Indicative cost estimates provided by particpants in the industry are in the vicinity of $3-$6 million[8] for the initial systems and process changes required to implement the measure, with an ongoing cost of $500,000[9] to provide this information on just one of their products.

As previously stated, the inconsistency in the application of the provisions of the client opt-in renewal provisions (to new clients only) and the fee disclosure statement provisions (to new and existing clients), is exacerbated by the requirement that the fee disclosure statement must be provided with the renewal notice under the opt-in provisions in s962K and s962L(2). This inconsistency further increases the cost of implementing the fee disclosure measures to all clients.

The alternatives proposed by the FPA

Recommendation: Retain current disclosure requirements

The FPA are recommending that the need for additional 'annual disclosure' requirement be removed on the basis that it is a duplication of information that is already given to the client in the Statement of Advice and Annual Statements. The cost it will impose on industry systems will be significant and we do not believe it will provide a benefit that will outweigh the additional costs it will ultimately add to the client's investment.

Alternative Recommendation: Subdivisions C – Disclosure for arrangements to which Subdivision B does not apply, be removed from the Bill to ensure fee disclosure statement provisions apply prospectively only to new clients from 1 July 2012.

Should the above recommendation not be accepted, the FPA recommends that the annual disclosure statements only apply to ***new*** clients from 1 July 2012. This will ensure the cost of implementing the fee disclosure statement provisions are kept to a minimum for clients and reinstate consistency between the client renewal opt-in provisions and fee disclosure requirements as they would then both apply to new clients only.

The FPA believes this alternative recommendation presents an acceptable compromise, particularly in light of the fact that the application of the fee disclosure statement requirement to ***all*** clients was not discussed

[8] *Confidential*
[9] *Confidential*

with the industry at any point prior to the details being released in the Bill tabled into Parliament. With just over 6-months until the commencement date of the legislation the FPA believe these are the only two options that could possibly be complied with.

The FPA also recommends as part of this alternative recommendation that amendments be made to section 962H(2), to remove the prescriptive and complex nature of the fee disclosure statement requirements. As previously highlighted many disclosure obligations about fees already exist and this will do nothing more than add further cost and duplication. Therefore to provide flexibility in allowing industry to comply in a more efficient and effective manner the information requirements for the fee disclosure statement should be removed from the legislation and the PJC should recommend that the detail be reverted back to industry for consultation.

ENHANCED ASIC POWERS

What is being proposed in the legislation?

The FPA applauds the Government and ASIC for trying to prevent future events and stop issues before they result in consumer detriment, and supports the intent of increasing ASIC's powers. However, the FPA believes a balance is needed between prevention and the ability to take away someone's livelihood prior to committing a breach. Schedule 1 – Amendments include the phrases **"reason to believe"** and **"is likely to contravene"**. The use of these phrases creates very open and flexible powers for the Regulator with minimal obligation on ASIC and permits the Regulator to take action before a breach has occurred.

There is a need for either the Explanatory Memorandum and/or the Regulations to detail an objective test. ASIC would have to show cause for the Regulator to have "reason to believe" that an applicant, licensee or provider is "likely to contravene" its obligations. This should include a range of actions ASIC could consider taking to address the "likely" contravention. The decision to undertake action based on a "reason to believe" that an applicant, licensee, authorised representative or provider "is likely to contravene" an obligation, should be made by an appropriately qualified and experienced senior/executive ASIC representative.

Penalties

In the "Note" provision of most sections of the draft legislation, it states that the provider may be subject to a banning order if it contravenes its obligations; and the licensee/authorised representative, civil penalties.
While the FPA notes the use of the word "may", we are concerned by the lack of detail around the action ASIC would be permitted to take if the Regulator has "reason to believe" a licensee or provider is "likely to contravene" its obligations. ASIC action based on a "reason to believe" that a contravention is "likely" to occur, while preventative, is permitting the Regulator to take action before a breach has actually been committed. Hence, the action undertaken by ASIC must be appropriate for such a "pre-breach" decision. For example, further investigations, an Enforceable Undertaking, education, etc. If such action is not complied with, more severe penalties could then be imposed.

The alternatives proposed by the FPA

The FPA recommends either the Explanatory Memorandum and/or the Regulations to detail:

- an objective test ASIC would have to meet to show cause for the Regulator to have "reason to believe" that an applicant, licensee or provider is "likely to contravene" its obligations.
- a range of appropriate action for the Regulator to take if the Regulator has "reason to believe" a licensee, representative, applicant or provider is "likely to contravene" its obligations. For example, further investigations, an Enforceable Undertaking, education, etc
- While the FPA supports the intention to enhance ASIC powers as previously stated, in order to keep integrity in the system, the FPA would like to see that ASIC are made responsible and held accountable in applying their powers.

TRANCHE #2

BEST INTEREST

Subdivision B - Provider must act in the best interests of the client

The FPA supports a best interest duty that places the client's interest first. Placing the client's interests first is a hallmark of professionalism, requiring the financial planner to act honestly and not place personal or employer gain or advantage before the client's interests. The best interest duty should require financial planners to be motivated by and give priority to the interests of the client ahead of their own interests, and the competing duties to their employer and/or licensee, in the preparation and provision of financial advice to consumers.

The FPA has in its dialogue with the government and prioritise treasury also supported the notion that financial planners who follow the correct process, who priorities their client's needs, and who have the correct motivation should have nothing to fear from over-zealous enforcement, or from malicious litigation. They should enjoy some protection from the operation of the law.

To avoid the imposition of unnecessary cost and compliance burdens on professional advisers and professional advice businesses, as far as possible, this protection should be afforded legislative certainty rather than merely being left to regulatory guidance or the courts.

The FPA remains concerned that the formulation of the duty in Section 961B(1) might be an encouragement to litigation or over zealous enforcement given the history of statutory use and judicial interpretation of the term 'best interest'. It is our view, that 'best' in this context is not intended to be absolute or objective, but is always referable to the subjective circumstances in which a piece of financial advice is given and with reference to reasonableness. In the context of professional advisers giving professional advice our view is that the test is not intended to imply any higher duty at law than that of the reasonably diligent professional financial adviser acting competently. In providing this comment we reference the term 'professional' advisedly, since truly professional advice places the interests of the client ahead of any 'commercial' interest that might attach to the provision of the advice.

Section 961B (2)(a)-(f) provides a list of steps that a financial planner must take to ensure they satisfy the duty. These are steps that we expect most financial planners acting in good faith and under the guidance from their licensee will already be doing in practice as they are largely imported from the existing legal requirements under s945A.

We caution that the use of the term 'subject matter of the advice' warrants explanation. In our view the government's consumer protection objectives may not be met if this is merely interpreted by the provider of the advice to mean a class or a type of financial product. In our view the subject matter of the advice is the client need or issue or the relevant client circumstances that the provider is engaged to advise upon and which the advice is intended to address. Unfortunately this gives rise to something of a paradox in that Chapter 7 of the Corporations Act is directed towards the regulation of financial product advice and may turn out to be a relatively poor legislative vehicle for regulating the process by which such advice may be *professionally* undertaken.

Subsection (g) requires that financial planners turn their mind at the time of giving the advice to any thing else not already covered in the steps (a)-(f) that might be reasonably required in the best interests of the client, given the client's relevant circumstances.

The FPA recommends that further detail be provided as to what this will mean in practical terms. Further the FPA recommend that further examples be added to the EM to provide further clarity to the industry.

Whether any additional steps are in fact required to meet the duty will always come back to individual circumstances at the time of the advice. Whilst those operating within the normal framework of the professional advice community should experience a greater degree of comfort, additional examples referencing the circumstances of professional advice would assist in managing this expectation of the legislation.

The legislation in s961E defines when it will reasonably be regarded as being in the best interest of the client to take an (additional) step. The FPA also expects there will be a role for ASIC and for the profession in developing guidance covering common scenarios where an additional step under subsection (g) may be required. The FPA applaud the recent ASIC media release which announced amongst other things ASIC's commitment to releasing guidance that sets out ASIC's expectations for meeting the best interests duty.

It should also be noted that the formulation of the best interest duty was never going to be and neither should it be the avenue in which advice was going to be made more accessible and affordable. The Government had promised that this would be an outcome of FOFA but at this stage we agree with many in the profession that it is clear that Government is unlikely to meet this policy objective with the Bill as drafted. We will look for relief from adverse regulatory impacts for professional advisers applying professional guidance intended to enable the scaling down from the full professional holistic advice obligations in order to meet a client's need for cost effective and efficient advice delivered within a client directed charging model suitable to the client's needs, circumstances and priorities.

The FPA submits that Increased regulation will never result in advice becoming cheaper and more affordable – and the provision of scaled advice within superannuation funds (also known as intra-fund advice) simply hides the true cost of that advice, by allowing it to form part of an administration fee subjected to every member of the fund. The FPA is concerned that access to affordable advice for middle Australia is of equal importance to the objective of improving the fairness and quality of advice.

The FPA recommends that the Government works with industry and the FPA to help develop a 'financial aid' type programme to ensure all Australians have access to financial advice. This follows on from previous FPA submissions outlining options for consideration in helping Australians to access financial advice such as tax deductibility of advice fees and rebates for middle to low income earners.

Paragraph 961B Provider must act in the best interests of the client

(2) The provider satisfies the duty in subsection (1), if the provider has done each of the following:

> d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice.

The meaning of the word 'expertise' is unclear in this context. According to the Macquarie Dictionary (2nd Revised Ed) the term is referable to a special skill or knowledge. Arguably some who provide financial advice already lay claim to fields of specialist knowledge such as financial planning or stockbroking. Is every financial planner or stockbroker providing financial advice within the meaning of the Corporations Act therefore an expert financial planner by definition? Further, it is unclear whether professional concepts which go to the heart of advice quality such as experience, competence, and capacity are intended to be omitted from the meaning in the use of the term expertise. It could be interpreted that the financial planner simply has the required knowledge of a 'subject matter' when in actual fact it may require the financial planner to have a minimum level of experience to allow them to actually identify all of the possible solutions that may in fact be in the best interest of the client. For this reason the FPA recommends the word 'expertise' be clarified in the legislation or the forthcoming regulations.

> g) taken any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

This final step perhaps presents the greatest hurdle for financial planners and their licensees to ensuring compliance with the 'best interest' measures. The FPA believes that recognition needs to be given to the fact financial advice models need to be able to be cross checked against the existing legislation to ensure financial planners and licensees are confident that the advice being provided is compliant.

Section (g) as it is currently drafted presents the issue that where an adviser has not considered a particular option, whether it is because they are not aware of the benefits of the strategy or because they did not believe it to be the optimal strategy, an adviser may later be sued by a client who believes the advice they were provided was not in their 'best interest. For example a client is a member of a Self Managed Super Fund (SMSF) and they are interested in buying a property within their SMSF, they have told their adviser they would be interested in utilizing the limited recourse borrowing arrangements as they do not have all of the funds available within their SMSF to purchase the property. The strategies that were not considered and discussed included buying the commercial property as tenants in common and through a unit trust. Several years down the track interest rates are at record highs and the SMSF is forced to sell the property at a loss. The client sues the financial adviser under section 961B (2)(g) claiming the financial planner did not act in their best interest.

The FPA recommends further clarity is provided in both the legislation and the regulations that define the limitations surrounding section (g). The FPA are proposing that the applicable wording from the EM (paragraph 1.43) be applied to the legislation to effect the following: 'taken any other reasonable step that would be reasonably regarded as being in the best interests of the client, given

the relevant circumstances at the time of advice'. Further the FPA recommends that additional examples are provided in the EM that provide further clarity around the intended application of section (g).

Paragraph 961H(5) *Nothing in this section affects the duty of the provider under section 961B to make reasonable inquiries to obtain complete and accurate information.*

The FPA does not support the assumption in 961H(5) that provision 961B creates a duty on the financial services licensee. 961B only applies to the actual 'providers' of the financial advice. Licensees can only breach the best interest duty obligations under 961B indirectly if their representatives breach their obligations (see 961L Licensee must ensure compliance).

Under the legislation licensees cannot breach the best interest obligations directly or in their own right as there is no best interest duty that applies to the behavior and actions of the licensee.

However, the FPA supports the need for a clear positive obligation on licensees to avoid a conflict, give priority to clients, or act in the clients' best interest.

The FPA recommends a positive obligation on licensees to give priority to their clients (considered as a whole) to be included in the legislation, similar to provider obligations under provision s961L.

s961E What would be reasonably regarded as in the best interests of the client?

It would be reasonably regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step.

The FPA believes that the drafting of this provision does not provide the clarification intended, especially the multiple references to 'reasonableness' and the context in which it applies.

The FPA recommends that this be reviewed with appropriate amendments to help better clarify the intent and definition of 'what would be reasonably regarded'.

CONFLICTED REMUNERATION (Division 4, Subdivision B)

Group life within a superannuation fund (section 963B(2) & (3))

The concept of 'group life' insurance' is well established within the financial services industry. It is commonly understood to mean the structural arrangement whereby insurance is purchased from a life company by a trustee of a superannuation fund on behalf of a 'group or class' of members and subsequently offered by that trustee to its members. The structuring of the policy in this way provides many administrative and cost benefits for trustees and their members.

It should be noted that a 'group life' insurance policy does not mean that insurance available under the 'group life' policy cannot be tailored for individual members or that an individual cannot seek financial advice specific to their needs. A 'group life' insurance policy is an insurance contract, which covers a group or class of members of a superannuation fund whereas an individual policy is an insurance contract, which covers an individual member only. Whether a policy is a 'group life' or 'individual' insurance policy does not prohibit a member of the superannuation fund from obtaining personal financial advice on their insurance needs.

The FPA understands that the reason for a ban on commissions for 'group life' is the assumption that members within a 'group life' insurance policy will not have received individual financial advice in respect of their insurance options. Therefore the Government's policy intent is to stop financial planners receiving commissions from insurance premiums paid by members of a 'group life' insurance policy (inside super) that they did not provide individual personal financial advice for. However, the legislation, from our perspective, is unclear in its application and appears to capture circumstances that were not intended.

Commissions paid in respect of individual life insurance policies are permitted whereas commissions paid in respect of 'group life' insurance policies (inside super) are prohibited, despite the fact individuals receiving life insurance cover under the 'group life' insurance policies may, like the individuals receiving cover under the individual life insurance policies, be the recipients of personal financial advice in respect of their life insurance cover.

Therefore the FPA believes there are some circumstances where commissions paid from a 'group life' insurance policy (inside super) should be permitted, as they are not the scenarios that the policy measure was designed to capture. For example:

- if a client who actively seeks individual personal advice and acts on financial advice to purchase an insurance policy through a 'group life' arrangement (inside super) in order to access the advantages of group life policy rates as an individual, commissions should be permitted. In this scenario the financial planner is only eligible to receive commission on the 'group life' insurance policy that they have provided individual personal advice on – not commission from all members of the 'group life' arrangement.

- Where a client seeks individual personal financial advice to review and top up their insurance needs, which happens to be within a 'group life' arrangement (inside super), commission for the financial advice relating to that individual's increase of insurance cover should be permitted. Again the financial planner is only eligible for the commission payable on the increase of life insurance cover and not from all members of the 'group life' arrangement.

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

Paragraph 963B(2) *A life risk insurance product is a **group life policy for members of a superannuation entity** if the product is issued to an RSE licensee of a registrable superannuation entity, or a custodian in relation to a registrable superannuation entity, for the benefit of a class of members of the entity.*

The policy intent of this provision is to stop financial planners receiving commissions from every member of a group life policy (inside super), especially if they did not provide individual personal financial advice to each member of that policy. The FPA is concerned that this goes further than the intended policy. In particular the legislation does not take into consideration that under the choice environment within superannuation many super funds are offering 'group life' style arrangements for individual retail clients for administrative convenience and to be able to provide retail clients with access to group style premium rates.

The FPA believe that the current inclusion and definition of 'group life' policies in sections 963B(2) has the unintended consequence of capturing insurance within superannuation choice environment.

The FPA recommends the definition in the legislation clearly articulate that where a client actively chooses to access and act on personal individual advice and chooses a particular insurance cover as a result of that advice, either through a group life arrangement or individual risk insurance policies inside superannuation, commission-based remuneration should be permitted.

The FPA recommends examples are included in the EM to illustrate the application of the definition and show allowable versus banned commissions such as those provided above.

Paragraph 963B(1)(d) *the benefit is given to the licensee or representative by a retail client in relation to:*

i) The issue or sale of a financial product by the licensee or representative to the client;
ii) Financial product advice given by the licensee or representative to the client;

In order to provide clarification and certainty that all forms of 'fee-for-services' arrangements are permissible provided there is client consent, irrespective of how the payment is facilitated the FPA recommends that s963B(1)(d) is amended as follows:

"the benefit is given to the licensee or representative by, *<u>or with the agreement consent or authority of</u>* a retail client in relation to:"

963C Non-monetary benefit given in certain circumstances not conflicted remuneration

Paragraph 963C(c) and (f)

> ***(c)*** *the benefit satisfies each of the following:*
> *(i) the benefit has a genuine education or training purpose;*
> *(ii) the benefit is relevant to the provision of financial product advice to persons as retail clients;*
> *(iii) the benefit complies with regulations made for the purposes of this subparagraph;*
> *(f) the benefit is a prescribed benefit or is given in prescribed circumstances.*

In order to meet Corporation Act requirements to ensure the competency of representatives in providing advice, licensees provide professional development opportunities for representatives. It is common practice for product providers to sponsor licensee conferences and professional development activity either by providing educational speakers, venues or funding for the venue.

The FPA seeks clarity as to the intended treatment of such sponsorship arrangements under section 963C and recommends the sponsorship of licensee professional development activity be permitted by specifically including it in the Regulations under section 963C.

Support services provided to a financial services licensee, or a representative of a licensee, by a 'benefit provider' (for example, a product provider) can include information technology software or support such as financial planning software. However it can also include non-technological support such as technical support services and paraplanning services offered as part of a 'financial advice' service offering. Hence, technical support services are different to information technology (IT) services. For example technical services delivered to financial planners include support and advice in the areas of taxation, superannuation (including SMSF), estate planning, life insurance and social security legislation. Effectively it is the provision of technical strategies and legislative analysis to financial planners.

While such technical support services relate to the provision of financial advice, they have no influence on the advice provided or product recommended and therefore should be separately defined as 'not conflicted remuneration' under s963C and explained in the Explanatory Memorandum.

The FPA recommends additional provisions be included under s 963C to clearly define technical support services provided by 'benefit providers' to licensees and/or their representatives, as 'not conflicted remuneration'. These additional provisions should be appropriately explained in the Explanatory Memorandum.

Explanatory Memorandum paragraph 2.33 *Professional development*

- *Domestic requirement – the professional development must be conducted in Australia or New Zealand.*
- *Majority time requirement – where 75 per cent of the time (during standard day of 8 hours or equivalent time) is spent on professional development. In a standard 8 hour day, this takes into account a one hour lunch break, as well as another hour that might be applied to other activities such as networking.*
- *Expenses – any travel costs, accommodation and entertainment outside of the professional development activity must be paid for by participants or its employer or licensee.*

The FPA notes the request for comments on the professional development definition in paragraph 2.33 of the EM and provides the following comments and suggested amendments.

The FPA does not support the limitation of the definition that restricts professional development to Australia and New Zealand. If a representative attends a professional development conference where the costs associated with the professional development activity (only) are covered by the licensee or employer as a benefit for work performance, and the benefit is open to all representatives, this should be permitted as long as the selection criteria for the benefit is not connected with conflicted remuneration. Professional development activity in overseas destinations should be permitted as long as the criteria for a representative to attend is not based on conflicted remuneration such as the value or number of products or investments recommended to clients.

For example, some licensees reward representatives with professional development activity related to advice based on the technical and compliance performance of the representative. The FPA believes professional development activity rewards are a legitimate incentive for encouraging representatives to improve their performance, as long as the incentives are not in any way dependent on or connected to the value or number of products or investments recommended to clients. Incentivising representatives to improve their technical and compliance performance, for example, can assist in raising the quality of advice provided to consumers.

Further if the Government is committed in developing Australia into becoming a financial services hub it needs to effectively compete with other jurisdictions. To limit professional development to only Australia and New Zealand unnecessarily limits our opportunities as a profession.

The FPA recommends the removal of the 'domestic requirement' provision in paragraph 2.33 of the EM for professional development activity.

963D Certain benefits given by an employer to an employee not *conflicted remuneration*

Paragraph 963D

a) *The benefit is remuneration for work carried out, or to be carried out, by the licensee or representative as an agent or an employee of an Australian ADI, or in otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI and*

b) *access to the benefit, or the amount of the benefit, is dependent on the licensee or representative recommending a basic banking product; and*

c) *the licensee or representative does not, in the course of recommending that basic banking product, give other financial product advice that does not relate to a basic banking product.*

The FPA is concerned that the wording of this section will prohibit independent financial planners from being able to utlise this provision of the basic banking product exemption. The way this section is currently worded, an independent financial planner will need to be individually authorised by each ADI they wished to deal with.

The FPA recommends section 963D (a) be amended:

> *"the benefit is remuneration for work carried out, or to be carried out, by the licensee or representative as an agent, representative or an employee of an Australian ADI, or in otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI; and*

Section 963D (c) to be deleted and replaced with wording consistent with that of section 963B(1)(a):

> *"the benefit is given to the licensee or representative solely in relation to a basic banking product".*

The FPA accepts the intention to permit bank tellers to provide advice to retail clients under existing remuneration sales targets. Given the high degree of media attention surrounding the removal of commissions on financial advice, the FPA recommends existing remuneration and advice disclosures must continue, or even be strengthened, in relation to this service provided by banks and ADIs to ensure retail clients clearly understand that these particular conflicted remuneration structures are being received.

The FPA is also concerned that 963D(c) provides a loophole and could result in advice provided by a bank or ADI to a retail client being split into two separate pieces of advice – one on basic banking products; and one on other financial product advice.

The FPA suggests this would be counter to the intent of the provision and of the FOFA reforms and therefore recommends restricting the splitting of a client's advice based on access to remuneration structures.

BAN ON ASSET-BASED FEES ON BORROWED AMMOUNTS (Subdivision B)

The Future of Financial Advice reform number one states that there will be a prospective ban on all conflicted remuneration structures, in relation to the distribution and advice of retail investment products including managed investments, superannuation and margin loans. The FPA is entirely supportive of this and led the way in responding to consumer concerns. However, to equate "asset based fees" with "conflicted remuneration" shows a profound (or potentially deliberate) misunderstanding of the fact that 'asset based fees' are not a form of remuneration at all, but very simply a form of 'calculating' remuneration. When coupled with the professional expectations that require client directed payment and prohibit product or strategy bias that act against a client's interest, it is clear that this form of calculation does not create conflict at all.

The issue that should be debated is not which calculation model is permissible for borrowed amounts, but whether the remuneration in the financial planning profession is respondent to professional expectations of practice, transparency and comparability and more than anything else, aligned to professional expectations of a service that delivers value.

Members of the FPA are required to adhere to our remuneration policy, which stipulates the following Six Principles:

1. Clients must be able to understand the fees they are paying
2. Clients must be able to compare the fees they are paying
3. Clients must be presented with a fee structure that is true to label
4. Clients must be presented with fees that are separated between advice and product
5. Clients must agree the fee with their financial planner and can request that the fee is switched off if no on going advice is required
6. Clients, rather than product providers, should pay for financial planning services, so as to remove potential for bias.

These principles provide the required safeguards for consumer protection without prescribing how a professional's fees must be calculated.

Setting the right remuneration calculation needs to be considered in the context of both professional and legal obligations. The FPA's professional expectations clearly require that irrelevant of the calculation method; fees (upfront or ongoing) can only be charged if a professional service is being provided. This is clearly spelt out in the agreement signed between a client and their financial planner and will be supported with a statutory best interest duty that will draw all non FPA members into a similar expectation of rejecting strategy and product bias that works against the clients interest.

It is the FPA's understanding that the proposed banning of asset-based fees on geared funds aims to target conflicts of interest where a financial planner is incentivised to recommend leverage (gearing) to increase funds under management and hence their fee income. The FPA notes this measure directly correlates to a recommendation from the Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry into Storm Financial to stop financial planners recommending gearing to clients to increase their fee.

While the FPA supports the intent of this policy measure, we believe the policy design is practically flawed and the issue of 'conflicts' will be addressed by the best interest duty obligations under s961B.

The FPA submits that asset-based fees have not been deemed or defined by Government (or any existing or proposed legislation) as conflicted. Further we believe that the banning of asset-based fees on geared funds is being disingenuous to the benefit that a statutory best interest duty obligation will provide. Government and industry must support that through legislation requiring that gearing advice (indeed any advice) is to be in the best interest of the client will assist in driving the behavioural change needed to address this issue for consumers.

Therefore, the FPA suggests the draft legislation under Subdivision B (964AB Application) is unnecessary and should be removed, due to its inconsistent application in relation to banning asset based fees only in certain scenarios, will create significant confusion and overwhelming complexity for both consumers and financial planners.

964D Financial services licensees must not charge asset based fees on borrowed amounts

Paragraph 964D(1)

> *(1) The financial services licensee must not charge an asset-based fee on a borrowed amount used or to be used to acquire financial products by or on behalf of the client.*

The policy intent of this provision is to remove the incentive for financial planners to unnecessarily gear clients to maximise their fee potential. The FPA notes this provision directly correlates to a recommendation from the Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry into Storm Financial to remove the incentive for financial planners recommending gearing to clients to increase their fee income.

While the FPA supports the intent of this provision, we believe that this concern will be addressed by the introduction of a best interest duty obligation as proposed under 961B. Requiring the gearing advice to be in the best interest of the client will assist in driving any behavioural change to address this issue for consumers.

The following circumstances should be explicitly excluded from the provision in the regulations under 964D(4):

- Where the financial planner is not responsible for and has not recommended the client borrow to invest (the gearing). For example, the client already has geared funds and requests an investment strategy from the financial planner.
- An existing client has a geared portfolio prior to the commencement of the Bill, and 'tops up' the gearing for further investment opportunities following the commencement of the Bill.

TRANSITION AND IMPLEMENTATION

The FOFA reforms are widely considered to be as substantial as the introduction of the Financial Services Reform (FSR) Act. We note that the FSR Act commenced in 2002 with a 24 month transition period, and in contrast the FOFA draft exposures have had an accelerated consultation period with no transitional period proposed upon commencement.

While the policy objectives of the FOFA reforms have been known and hotly debated over the past two years, the detailed legal obligations required by financial planners, authorised representatives and licensees which dictate the business practices needed to comply with the obligations, will not be known until the legislation successfully passes through Parliament. Given the pending adjournment of Parliament over the Christmas period, and the level of stakeholder interest in the FOFA reforms, it is foreseeable that this could take some time with the potential of legislation receiving Royal Assent as late as the autumn sitting in 2012. This would leave only a short period of time for industry to ensure business processes, systems and practices meet the detailed obligations of the new law by the commencement day of 1 July 2012.

The FPA acknowledges the announcement by ASIC in the media release issued on the 13th of December to provide a 12-month assisted compliance period to assist compliance with the best interest measures, however we do not believe this is sufficient in helping the industry meet the current 1 July 2012 deadlines.

Given the significant change in industry practice, business models, systems and operations for licensees and providers, the FPA recommends the hard-compliance date be delayed by two-years to a commencement date of 1 July 2014 to ensure compliance with the new obligations can be achieved with as little disruption as possible to the provision of quality advice to consumers.

OTHER ISSUES FOR CONSIDERATION

Part 10.18 – Transitional provisions relating to the Corporations Amendment (Further Future of Financial Advice Measures) Act 2011

1528 Application of ban on conflicted remuneration

(1) Subject to subsection (2), Division 4 of Part 7.7A, as inserted by items 24 of Schedule 1 to the amending Act, does not apply to a benefit given to a financial services licensee, or a representative of a financial services licensee, if:

a. The benefit is given under an arrangement entered into before the day on which that item commences; and

b. The benefit is not given by a platform operator.

The FPA understand that it is not the Government's intention to capture trail commissions established under contracts established prior to 1 July 2012. We are however concerned that the drafting of the legislation which was intended to capture 'volume payments' will inadvertently capture trail commissions that are paid by platform operators to financial planners.

The FPA recommends that this uncertainty be addressed either through amendment to the Act such as removing s1528(1)(b) and (2)(b) or alternatively through regulations as permitted under 1528(3).

Corporations Amendment (Further future of financial advice measures) Bill 2011- Explanatory Memorandum

Paragraph 1.33 …'the provider must take into account the client's overall circumstances'

The FPA are concerned that word 'overall' could capture information about the client that was not relevant at the time of discussions and for this reason we are recommending the word be replaced with 'relevant' to ensure a more accurate reflection of the legislative intent.

APPENDIX A:

Historical overview of the development of the Future of Financial Advice Reforms

PJC Inquiry Recommendations	Government support Yes / No	Government Reform Information Pack One	Government Reform Information Pack Two	Exposure Draft - FoFA Bill 2011 Tranche 1 (ASIC Powers and Opt-In Renewal requirements; Best Interest)	FoFA Bill Tranche 1 (ASIC Powers and Opt-In Renewal requirements)
Recommendation 6 The committee recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry.	Support.	• Strengthen the powers of the corporate regulator (ASIC) in relation to the licensing and banning of individuals from the financial services industry. • ASIC's powers to remove persons from the industry will also be enhanced, as it will be able to take into account a wider range of matters at the banning stage. • ASIC's will be able to remove participants from the financial services industry who might cause or contribute to investor losses.	The announced changes to ASIC's licensing and banning powers will be included in the exposure draft of legislation implementing the reforms.	ASIC powers to make banning orders have been strengthened to include when: • ASIC has reason to believe that the person is not of good fame and character; • ASIC has reason to believe that the person is not adequately trained, or is not competent, to provide a financial service or financial services; • the person has been involved in the contravention of a financial services law by another person; • ASIC has reason to believe that the person is likely to become involved in the contravention of a financial services law by another person. Considerations In employing these power, ASIC must have regard to any conviction of the person, within 10 years before that time, **for serious fraud**	ASIC powers to make banning orders have been strengthened to include when: • ASIC has reason to believe that the person is not of good fame and character; • ASIC has reason to believe that the person is not adequately trained, or is not competent, to provide a financial service or financial services; • the person has been involved in the contravention of a financial services law by another person; • ASIC has reason to believe that the person is likely to become involved in the contravention of a financial services law by another person. Considerations In employing these power, ASIC must have regard to any conviction of the person, within 10 years before that time, **for an offence that involves dishonesty and is punishable by imprisonment for at least 3 months**;
Recommendation 8 The committee recommends that sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.	Support.	• Strengthen the powers of the corporate regulator (ASIC) in relation to the licensing and banning of individuals from the financial services industry. • ASIC will be able to take into account a broader range of matters when determining whether to issue a licence, or whether to cancel or suspend a licence. • ASIC's will be able to restrict entry into, or removing participants from, the financial services	The announced changes to ASIC's licensing and banning powers will be included in the exposure draft of legislation implementing the reforms.	ASIC powers to reject or cancel a license have be strengthened to permit ASIC to: • deny an application, or suspend or cancel a licence where ASIC has reason to believe that the licensee (915C) or a person (920A) is likely to contravene their obligations under section 912A	As per Exposure Draft

APPENDIX A:

		industry who might cause or contribute to investor losses.			
Additional measures introduced by Government (not recommended by the PJC)					
1. Client opt-in annual renewal and fee disclosure statement		• The introduction of adviser charging regime, which retains a range of flexible options for which consumers can pay for advice and includes a requirement for retail clients to agree to the fees and to annually renew (by opting in) to an adviser's continued services. • Advisers will be required to agree their fees directly with clients and disclose the charging structure to clients in a clear manner, including as far as practicable, total adviser charges payable, expressed in dollar terms. • Advisers will only be able to charge ongoing advice fees if a payment plan has been agreed with the client, or if the charge relates to the provision of an ongoing service. If an adviser is to provide an ongoing service, the adviser must send an annual renewal notice to the client. If the client does not renew the services, the adviser cannot continue to charge the client. • It is important to note that the adviser charging regime does not prevent client-agreed deductions being allowed from a client's investment to pay for financial advice or flex bility in payment options. • The client does not have to pay the advice fee, or ongoing fees, up front, and in full. While these deductions from a client's investment would need to be	• A **prospective** requirement for advisers to Retail clients to agree (by opting in) to ongoing advice fees every **two** years from 1 July 2012. • This will be supplemented by an intervening annual disclosure notice to be provided to the client detailing fee and service information for the previous and forthcoming year, informing the client of their right to 'opt-out' at any point in time to an ongoing advice contract. • The adviser will be required to send a prescribed renewal notice no less than 30 days prior to the relevant (two year) anniversary date; • This notice would outline the fee the client paid in the previous year and a description of the services they received, and fee and service information for the forthcoming year (also alerting the client to the fact that they can opt out at any time); • If the client does not respond to the notice or opts out, the adviser cannot continue to charge an ongoing advice fee, and nor can the client continue to expect management of their financial arrangements; • If the client is unresponsive to the renewal notice, the adviser can continue charging the client for an additional 30 day 'grace period' after the anniversary	<u>Fee disclosure statement</u> • **Prospective annual requirement applicable to new retail clients only.** • An annual fee disclosure statement will need to be provided to NEW retails clients for which an ongoing fee is being charged. • This requirement applies to **new clients only** from 1 July 2012. • The fee disclosure statement must include details of the fees charged and service provided for the last 12 months and expectation of what will be provided in the forthcoming 12 months from the disclosure day. • The disclosure day is 12 months from the anniversary date of the day the arrangement was entered into or 12 months from the date of the last statement. • **At least 30 days before the disclosure day,** the client must be given a fee disclosure statement. <u>Opt-in renewal</u> • **Prospective measure applicable to new clients only.** • A renewal notice will be required to be given to clients where advice arrangements where entered into for the first time on or after 1 July 2012. • A renewal notice is a statement which tells the client that they will need to	<u>Fee disclosure statement</u> • **Retrospective annual requirement applying to ALL retail clients – new and existing clients** • An annual fee disclosure statement will need to be provided to all retails clients for which an ongoing fee is being charged. • This requirement applies to **both existing and new clients** changing this to a **retrospective** measure. • The fee disclosure statement must include details of the fees charged and service provided for the last 12 months and expectation of what will be provided in the forthcoming 12 months from the disclosure day. • The disclosure day is 12 months from the anniversary date of the day the arrangement was entered into or 12 months from the date of the last statement. • The disclosure statement must be provided **within 30 days of the disclosure day.** <u>Opt-in renewal</u> • **Prospective measure applicable to new clients only.** • A renewal notice will be required to be given to clients where advice arrangements where entered into for the first time on or after 1 July 2012. • A renewal notice is a statement which tells the

APPENDIX A:

		facilitated by a product provider, this is not a commission, as the remuneration is not set by the product provider. Advisers cannot prefer product providers because this type of service is offered.	date; • Every second year where no opt-in renewal is required, a disclosure document would be required to be sent in its place, containing the same information normally contained in the opt-in renewal notice (for example, fee information); and • If a client does not respond to a renewal notice, they are taken to have chosen to opt-out 30 days after the anniversary date, meaning the adviser's liability for ongoing advice ceases at the point that they can no longer charge an ongoing fee (advisers will still be liable for advisory services already rendered to the client). • Only those advisers intending to charge ongoing advice fees to retail clients need to send the notice. • Issues around grandfathering arrangements will still be subject to further consultation. • The Government will consult with industry and stakeholders on the possible need for a penalty provision for a breach of the opt-in policy.	notify the adviser in writing and within 30-days of the notice period if they wish to continue to pay for the ongoing advice arrangement, and that where no correspondence is made by the client (ie. the client fails to opt-in) that the arrangement will beterminated. • The renewal notice and a fee disclosure statement will be required to be provided **at least 30 days before the renewal notice day.** • The renewal notice day is 2-years from the date the arrangement was entered into or 2-years from the date of the last renewal notice. • The renewal period 30 days beginning on the day on which the client is given a renewal notice and a fee disclosure statement. • If the 'opts-out' or does not 'opt-in' within the renewal period, the arrangement terminates at the end of a further period of 30 days after the end of the renewal period.	client that they will need to notify the adviser in writing and within 30-days of the notice period if they wish to continue to pay for the ongoing advice arrangement, and that where no correspondence is made by the client (ie. the client fails to opt-in) that the arrangement will be terminated. • The renewal notice and a fee disclosure statement will be required to be provided **within 30 days of the renewal notice day.** • The renewal notice day is 2-years from the date the arrangement was entered into or where one has already been issued, 2-years from the date of the last renewal notice. • An ongoing fee arrangement can be terminated at any time by the client. • It will be deemed to have terminated where the 'disclosure obligation' or 'renewal notice' obligation has not been met by the financial adviser.