

# **Post-Implementation Review**

Future of Financial Advice

Additional amendments

## Executive Summary

1. As part of the Government's Best Practice Regulation Framework, Treasury is required to undertake five Post Implementation Reviews (PIRs) on the regulatory impact of five Future of Financial Advice (FoFA) reforms.
2. The PIRs are required in relation to regulations related to:
  - the ban on up-front and trailing commissions and like payments for both individual and group risk insurance within superannuation.
  - the requirement for advisers to renew client agreement to ongoing advice fees every two years (opt-in regime).
  - the ban on soft dollar benefits over \$300 per benefit.
  - the limited carve-out for basic products from the ban on certain conflicted remuneration structures and best interests duty; and
  - the clarification provided in relation to access to scaled financial advice.
3. This PIR covers each of these regulations separately and examine the effects they have had on industry and consumers using the Regulatory Burden Measurement Framework developed by the Office of Best Practice Regulation.
4. Treasury is seeking submissions from stakeholders who have been affected by these regulations to assist with identifying and assessing the impacts of the regulations and quantifying compliance costs, where relevant.

# Introduction

## PURPOSE OF THE POST-IMPLEMENTATION REVIEW

5. All Australian Government agencies need to undertake PIRs when regulation has been introduced, removed, or significantly changed without a regulation impact statement (RIS) having been approved by OBPR.
6. The development of RISs or PIRs is an important component of the Government's Best Practice Regulation Framework, which is designed to help ensure the delivery of efficient regulatory outcomes and in preventing unnecessary red tape.
7. A RIS subjects the proposed regulation to scrutiny at the pre-decision stage, while a PIR is post implementation scrutiny of the regulation.
8. Treasury is required to undertake five PIRs relating to specific regulations introduced as part of the Future of Financial Advice (FoFA) reforms. While RISs were prepared in relation to each of these regulations, they were not approved by the Office of Best Practice Regulation prior to the announcement of the reforms.
9. The PIRs will assess the impacts of the following regulations:
  - the ban on up-front and trailing commissions and like payments for both individual and group risk insurance within superannuation;
  - the requirement for advisers to renew client agreement to ongoing advice fees every two years as part of the opt-in regime;
  - the ban on soft dollar benefits over \$300 per benefit;
  - the limited carve-out for basic products from the ban on certain conflicted remuneration structures and best interests duty; and
  - the clarification provided in relation to access to scaled financial advice.
10. The impacts of each of the above regulations will be considered together.
11. Since these regulations did not become mandatory until 1 July 2015, the PIRs must be completed by 1 July 2017.

## WHAT IS FOFA?

6. The Future of Financial Advice (FOFA) reforms are focused on improving the quality of financial advice and building trust and confidence in financial advisers and the financial system more generally through improved regulation to better align the interests of advisers and their clients.

7. The FOFA legislation is contained in part 7.7A of the *Corporations Act 2001* (the Act), which imposes the following standards on providers of financial advice:
  - a best interests obligation that requires financial advisers to act and provide advice that is in the best interests of their client;
  - an obligation to disclose ongoing fees and charges paid by their client; and
  - a requirement not to accept payments that may influence the advice provided to the client.

## **Ripoll Inquiry**

8. FOFA has its genesis in the recommendations of the 'Ripoll Inquiry', a Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into financial products and services in Australia. The Ripoll Inquiry was set up in 2009 to inquire into, and report on, issues associated with financial products and services provider collapses that occurred in the wake of the Global Financial Crisis (GFC).
9. The Ripoll Inquiry was undertaken in the context of the collapses of a number of financial advisory firms, including Storm Financial and Opes Prime. The terms of reference for the Ripoll Inquiry covered:
  - the role of financial advisers;
  - the general regulatory environment for these products and services;
  - the role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;
  - the role played by marketing and advertising campaigns;
  - the adequacy of licensing arrangements for those who sold the products and services;
  - the appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;
  - consumer education and understanding of these financial products and services;
  - the adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and
  - the need for any legislative or regulatory change.

10. The report made a number of recommendations for reform of the financial advice sector. The government's response was the introduction of the FOFA reforms.
11. The FOFA reforms were legislated in two tranches through the *Corporations Amendment (Future of Financial Advice) Act 2012* and the *Corporations Amendment (Further Future of Financial Advice measures) Act 2012*.
12. Complying with FOFA was voluntary between July 2012 and July 2013 and became mandatory from July 2013 onwards.

## **WHAT IS COVERED IN THIS POST-IMPLEMENTATION REVIEW**

13. This review does not cover the entirety of the FOFA reforms, as a compliant RIS was prepared. This review covers five specific measures announced on 28 April 2011 as compliant RISs were not prepared on these measures prior to announcement.
14. The measures are:
  - the ban on up-front and trailing commissions<sup>1</sup> and like payments for both individual and group risk insurance within superannuation;
  - the requirement for advisers to renew client agreement to ongoing advice fees every two years (opt-in);
  - the ban on soft dollar benefits over \$300;
  - the limited carve-out for basic banking products from the ban on certain conflicted remuneration structures and the best interests duty; and
  - the clarification of the operation of the best interests duty in relation to scaled advice.

### **A. PROSPECTIVE BAN ON UP-FRONT AND TRAILING COMMISSIONS AND LIKE PAYMENTS FOR BOTH INDIVIDUAL AND GROUP RISK INSURANCE WITHIN SUPERANNUATION**

15. This amendment banned conflicted remuneration, including up-front and trailing commissions and like payments for both individual and group life risk insurance within superannuation.

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<sup>1</sup> An up-front commission is a payment made to an adviser when purchasing a financial product, a trailing commission is any payment made to an adviser every year that you hold an investment.

## **Problem**

### *Impact of conflicts of interest*

16. Commission based payments can create real and potential conflicts of interests for advisers by encouraging advisers to sell products rather than give strategic advice that is in the best interest of the client.
17. A consistent theme of the Ripoll Inquiry was the impact that conflicts of interest have on the provision of financial advice. The Ripoll inquiry noted that ‘a significant conflict of interest for financial advisers occurs when they are remunerated by product manufacturers for a client acting on a recommendation to invest in their financial product’.<sup>2</sup>
18. Further, it can be difficult for a client to assess the quality of the advice they are receiving and whether it is in their best interest. Indeed, the primary reason why a client will typically seek out financial advice is to utilise the specialised knowledge of the financial adviser. This situation reflects the information asymmetry that exists between financial advisers and their clients.
19. Prior to the introduction of FOFA, the regulatory response to conflicts of interest was a legislative requirement to disclose conflicts of interest and provide advice to a standard that is appropriate to the client. However, many submissions to the Ripoll inquiry noted that this regulatory response had proved ineffective.<sup>3</sup>
20. In particular, although disclosure can make a client aware that a conflict of interest exists, due to the information asymmetry that exists between the adviser and the client, the client may not be able to determine the extent to which the conflict of interest has impacted on the advice given.
21. One of the key objectives of FOFA was to remove these conflicts of interest and require financial advisers to put the needs of their client first.

### *Conflicts of interest in relation to life risk insurance within superannuation*

22. Prior to FOFA, conflicted remuneration structures existed in relation to life risk insurance within superannuation funds.
23. This reflected in part the way in which group life risk insurance was purchased compared to other financial products. For example, group risk insurance is bought by a trustee on behalf of members and offered by that trustee to its members. In this context, an adviser can assist members of a superannuation fund in the

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<sup>2</sup> Ripoll inquiry page 75 paragraph 5.29.

<sup>3</sup> Ripoll inquiry page 74 paragraph 5.24.

composition and level of cover that they should have. However, if the member receives no advice, they are still likely to be insured through default arrangements unless they choose to opt-out.

24. Other examples of conflicted remuneration structures in relation to life insurance within superannuation are where a superannuation specialist advisory group makes a recommendation to an employer about which default fund to select over another fund and then receives service fee payments from that default fund for providing education and other services to employees who join the default fund.
25. An ASIC shadow shopping survey conducted in 2006 found that there was a positive correlation between non-compliance with legislative requirements and conflicts of interest for all advice relating to superannuation, including life insurance. The survey found that where a conflict of interest existed, around 30 per cent of advice was non-compliant and when a conflict of interest did not exist, around 5 per cent of advice was non-compliant.
26. The Super System Review (Cooper Review), which also looked into the issue of insurance arrangements within superannuation, found that commission-based payments for insurance within superannuation also had the potential to affect the quality of advice provided by financial planners when giving their superannuation advice.

#### **Why was government action required?**

27. As part of FOFA, the previous government took action to ban conflicted remuneration in relation to investment and superannuation products because there were concerns it was distorting the quality of financial advice.
28. The legislative requirements in place at the time were considered to be unable to adequately address these issues. For example, because there were no requirement for financial advisers to act in the best interests of the client, many advisers were receiving up-front commissions for advising products that were not in the client's best interests, resulting in poor consumer outcomes. These regulatory failures could only be addressed through legislative change, necessitating government action.

#### **Objectives of Government action**

29. The previous government's objective was to ensure that the remuneration structures of life insurance advisers were appropriately aligned with the interests of their clients.
30. However, the government did not want to eliminate a channel for distributing life insurance cover given this could increase levels of underinsurance in the Australian

community, a study<sup>4</sup> by Rice Warner has shown that there is already a persistent underinsurance gap in Australia.

### **Options that were considered**

31. The previous government considered four alternative options to address this problem.

#### *Chosen option: Ban insurance commissions in relation to all policies in superannuation*

32. Under this option, commissions and similar payments were prohibited in respect of any life insurance offered to any superannuation entity, including self-managed superannuation funds (SMSFs).
33. Under this option, life insurance advisers would only be able to receive commissions from product providers on policies sold outside of superannuation.
34. Commissions in relation to life insurance sold outside of super has also been addressed in the Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017.

#### *Alternate option A: Ban insurance commissions in relation to MySuper only*

35. Under this option, trustees of MySuper products<sup>5</sup> would not have been able to pay premiums for insured member benefits that include commissions.
36. This option would have eliminated life insurance commissions on default superannuation products, while allowing commissions on non-default products.
37. This would have meant that where a trustee of a MySuper product procures any group insurance cover to offer to its members, no commission could be paid in relation to that policy. Where a trustee engaged an adviser to develop a group insurance package for MySuper members, that adviser could not receive any commissions from a product provider.
38. The option would have had the benefit of protecting consumers of MySuper products (who are typically disengaged consumers, given MySuper is the default superannuation option) from having their default insurance cover being influenced by commissions.
39. However, this option was not selected for the following reasons:

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<sup>4</sup> Rice Warner Report: Australia's Persistent Underinsurance Gap

<sup>5</sup> **MySuper** is a Government superannuation initiative to provide low-cost and simple super products for employers to choose as their default super fund.

- Firstly, cover above the automatic acceptance limit of the group insurance contract offered in a superannuation product must be taken out of an individual policy. As commissions were permitted on individual policies, financial advisers would have an incentive to recommend the member increase cover above the automatic acceptance limit to receive a commission payment, which may not have been in the client's best interest.
- Secondly, there would be an incentive for financial advisers to recommend their clients move out of a MySuper product [to another life insurance product] where commissions were permitted, which may not have been in the client's best interest.

*Alternate option B: Ban insurance commissions in relation to group policies in superannuation only*

40. This would have meant that where a trustee of a superannuation fund procured a group policy to offer to its members, there could be no commission payments in relation to that group policy. Where a trustee engaged an adviser to develop a group policy for its members, that intermediary could not receive any commission from a product provider.
41. This option was not selected due as it would create the same undesirable incentives discussed under alternative option A.

*Alternate option C: Ban commissions in relation to all life insurance policies in superannuation and commissions in relation to all other all life insurance products*

42. Option C would have banned commissions on all life insurance policies whether within or outside of superannuation. The key difference between the chosen option and this option is that there would be a ban on commissions on life insurance policies outside of superannuation.
43. Superannuation fund members have balances that can be drawn on to pay for a range of services, including insurance advice. However, this is not the case for consumers seeking advice on life insurance products outside of superannuation. While some consumers may be willing to pay for such advice, there is a moderate/significant risk that other consumers may either purchase cover directly from an insurer (without receiving advice) or may not obtain life insurance cover at all, which could worsen consumer outcomes.
44. The above could also result in some financial advisers having to exit the market or lose business, which would have an adverse impact on individual advisers and, where there was a lessening of competition, reduce access to affordable advice.
45. Due to these concerns, this option was not implemented.

## **REQUIREMENT FOR ADVISERS TO RENEW CLIENT AGREEMENT TO ONGOING ADVICE FEES EVERY TWO YEARS (OPT-IN) RATHER THAN ANNUALLY**

46. This amendment required financial advisers to renew client agreement to ongoing advice fees every two years.
47. When FOFA was initially announced, it was intended that the financial advisers would be required to ask their clients to opt-in on an annual basis.

### **Problem**

48. In situations where the client pays a proportion of a financial adviser's remuneration directly (known as 'fee for service'), it is common for the remuneration to be ongoing in nature. For example, an adviser might charge a client an ongoing annual fee calculated as a percentage of the client's funds under management (known as asset-based fees) or a flat dollar amount.
49. This annual fee generally covers a range of advisory services provided (or available) to clients. As opposed to professions or other occupations that tend to charge for transactional, one-off services or advice, financial advisers' remuneration structure is partly reflective of the notion that the benefits of financial advice tend to be realised over the medium to long-term, and therefore remuneration structures tend to reflect the ongoing nature of the adviser/client relationship.
50. Typically the ongoing contract would include a feature to allow the consumer to 'opt-out' of the arrangement if they wished to do so.
51. An 'opt-in' requirement means that financial advisers that have an ongoing fee arrangement with a retail client must instead obtain their client's agreement at least every two years to continue the ongoing fee arrangement. The objective of the opt-in requirement was to enable consumers to understand the fees they are paying for ongoing financial advice and make a further assessment about whether they are receiving value for money for the fees paid. It was also aimed at ensuring that ongoing fees could not be charged to retail clients that were uncontactable and therefore were not receiving financial advice.
52. When initially announced, the proposal was to require financial advisers to provide their clients with an opt-in notice annually. If a client did not opt-in within 30 days of receiving the notice, their ongoing arrangement would be terminated.

### **Why government action was required?**

53. As the opt-in requirement was imposed by legislation, amending this requirement also required government action.

### **Objectives of Government action**

54. As an annual opt-in requirement would have placed a significant burden on industry, as advisers would have been required to contact these client that were on an ongoing fee arrangements annually.
55. The objective of the government action was to lower the regulatory burden on industry while retaining the substantive benefits to consumers of opt-in.

### **Options that were considered**

56. The previous Government considered two potential options to address the problem:

*Chosen option: Change the opt-in requirement from an annual requirement to a two yearly requirement.*

57. Under this approach, financial advisers who have an ongoing fee arrangement with a retail client are required to obtain that client's agreement every two years to continue the ongoing fee arrangement.
58. This approach was selected as the previous government considered that requiring clients to opt-in every two years would retain the consumer protection elements of opt-in while lowering the regulatory impact on industry.

*Alternative option: retain the annual opt-in requirement as originally announced*

59. Under this alternative approach, opt-in would have continued to be an annual requirement. However, this would have imposed substantially higher regulatory burdens on industry without delivering a substantial improvement in consumer outcomes.

## **BAN ON SOFT DOLLAR BENEFITS OVER \$300**

- This amendment banned 'soft dollar benefits' (defined below) in excess of \$300 per benefit.

### **Problem**

60. A key principle of the Corporations Act is that consumers must be in a position to decide whether to rely on advice. In this regard, it is important that the consumer is made aware of any benefits their adviser has received or might receive as a result of providing the advice, given the potential conflict of interest.
61. Under the Corporations Act, licensees are obliged to have in place adequate arrangements for the management of conflicts of interest. A licensee (and its authorised representatives) must disclose any benefits and relationships in the

Statement of Advice (SOA) which may reasonably be expected to be capable of influencing the advice. There must be disclosure of benefits in the Financial Services Guide (FSG) where it is attributable to the advisory services. Further, there must be disclosure of benefits in the Product Disclosure Statement (PDS) if it could affect the consumer's financial returns from the product.

62. Following the FOFA announcement, the previous government gave consideration to the treatment of 'soft dollar benefits' in light of the prospective ban on conflicted remuneration.
63. There is no uniform definition of the term 'soft dollar benefits'. Soft dollar benefits can vary from minor gifts valued at \$50 to bonuses worth tens of thousands of dollars.
64. The broadest definition is used in *ASIC Report 30: Disclosure of soft dollar benefits* (ASIC Report 30) as 'any benefit received by a financial planning firm or its representatives or associates, other than basic monetary commissions or direct client advice fees'. The definition includes some monetary payments as well as non-monetary benefits.
65. The types of benefits that were identified in ASIC Report 30 include benefits offered by product providers or by the licensee which mainly go to individual advisers (often based on volume). This includes:
  - higher commission rates based on volume;
  - shares (or options) in the product provider or advice licensee;
  - a higher share of commissions paid to an adviser;
  - buyer of last resort agreements;
  - 'marketing support' payments;
  - free or subsidised business equipment or services, such as computers, software, and industry association membership fees;
  - adviser conferences; and
  - hospitality, such as tickets to sporting events.
66. The ASIC report also identified benefits paid by product providers to advice licensees or related platforms which included 'fee rebates' or profit sharing arrangements. These are benefits that are paid by product providers and licensees flowing to individual advisers, as well as benefits to parent companies.

67. ASIC Report 30 noted that most soft dollar benefits are funded indirectly from investment fees charged to consumers.
68. ASIC Report 30 also noted that revenue sources such as volume bonuses, fee rebates and equity links can be a major element in a licensee's whole business model and these benefits can make up the majority of the licensee's revenue (it should be noted that some of these payments would have already been covered to a large extent by the ban on volume payments but otherwise would constitute a soft dollar benefit if they were not based on volume). When this option was being considered, there was no available breakdown of revenue received for each of the different types of conflicted remuneration structures.
69. As noted in ASIC Report 30, soft dollar benefits have the potential to influence advice (directly or indirectly), through financial incentives and other more indirect means of behaviour modification.

#### **Why government action was required?**

70. Continuing to allow soft dollar benefits had the potential to undermine the FOFA reforms, by providing an alternative mechanism for product providers and/or licensees to influence recommendations which impacts on the quality of advice provided to consumers and, therefore, consumer outcomes.
71. Government action was required to restrict soft dollar benefits.

#### **Objectives of government action**

72. The objective of the previous government's action was to:
  - minimise or eliminate the use of remuneration practices that distort the quality of advice and adversely affect consumer outcomes;
  - encourage the provision of professional unbiased financial advice;
  - enable consumers to understand the fees they are paying for advice and the services that they are paying for; and
  - facilitate better market outcomes.

#### **Options that were considered**

*Chosen option: Prospective legislative ban on soft dollar benefits over \$300*

73. The selected option involved a prospective legislative ban on soft-dollar benefits over \$300. The ban includes any monetary or non-monetary benefit from a third party (or associate) over \$300 (per item) made available to a platform, licensee, adviser or related party.

74. An allowable benefit under \$300 was also required to meet the 'infrequent' or 'irregular' test for associated similar or identical benefits.
75. There was a carve-out from the ban for professional development that meets the education and other set criteria and non-commercially available IT software which is necessary for the conduct of the adviser's business. This relates to IT software that is provided as part of the licensee–representative relationship which is administrative in nature.
76. There may be disclosure of benefits not subject to the ban in existing disclosure documentation, such as the exemptions for professional development and administrative IT services. Disclosure is not expected for the allowable benefits under the \$300 threshold.
77. The prospective ban allowed for the grandfathering of existing contracts, which meant that existing contractual arrangements for the payment of benefits prior to the commencement of the ban could continue.
78. The use of a set monetary threshold is termed a 'bright line test' which is clear, simple and easy to apply. The threshold was set at \$300 as this was the amount deemed to be 'material' under the Financial Services Council (FSC)/Financial Planning Association (FPA) code on alternative remuneration.

*Alternative option A: Status Quo — manage potential conflicts of interest via disclosure*

79. This option would have maintained the status quo. The existing obligations for licensees to manage and disclose conflicts of interest (including soft-dollar benefits) would continue. Various disclosure documents would have continued to be provided to investors to assist them to understand the potential impact of remuneration based soft dollar benefits on the advice they received from financial advisers.
80. This option would have leveraged off the best interests duty introduced as part of the FOFA reforms (the best interests duty was announced prior to the ban on soft-dollar benefits, but was introduced at the same time).
81. Under this approach, soft dollar benefits would have been permitted, so long as they did not impair an adviser's duty to comply with the duty and the benefits were clearly disclosed to the client prior to the provision of advice.
82. This option was not selected because it had the potential to undermine the FOFA reforms by providing an alternative mechanism for product providers and/or licensees to receive remuneration that could result in poorer quality or inappropriate advice.

### *Alternative option B: Co-regulation*

83. Under this option, legislation, rather than banning soft dollar limits over a set amount, would have stipulated broad parameters for soft dollar benefits, such as a requirement to comply with an industry code of practice.
84. An existing industry code could be then revised and adopted by all persons providing personal financial product advice and all relevant industry bodies. The new code could either provide a ban or alternatively be based on the principles of existing industry codes, noting that industry currently takes different approaches.
85. Co-regulation, while having the benefits of encouraging industry to take action to address consequences of problematic remuneration structures, also created a risk that industry would take insufficient action (for example, set too high a threshold at which a ban applies) or would have non-uniform approaches (which means that consumers would have differing levels of protection depending on which code their adviser was a member of). For these reasons, this option was not selected.

## **LIMITED CARVE-OUT FOR BASIC BANKING PRODUCTS FROM THE BAN ON CONFLICTED REMUNERATION AND THE BEST INTERESTS DUTY**

- The effect of this amendment is that the ban on conflicted remuneration and the full best interests duty does not apply in the case of advice or distribution of a basic banking product<sup>6</sup> through an employee of the Authorised Deposit Taking institution that issued the product. The carve-out also does not apply when the employee provides advice on a combination of basic banking products and other more complex financial products.

### **Problem**

86. The ban on conflicted remuneration attempted to address conflicts of interest which adversely affect the quality of financial advice received by a client. The best interests duty reflects the need to ensure that advisers act in the best interests of clients and give priority to the interests of the client above any other interests.

### *Concerns about the ban on conflicted remuneration in relation to basic banking products*

87. Basic banking products are distributed by Australian Deposit-taking Institution (ADIs) regulated by the Australian Prudential and Regulation Authority (APRA).
88. In relation to the distribution of retail banking products, some ADIs operate a 'no advice' model in their branches and call centres relying on the existing 'clerks and

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<sup>6</sup> A basic Banking product is defined in the Corporations Act 2001 as a basic deposit product, or a facility for making non-cash payments or travellers cheques.

cashiers' exemption in subsection 766A(3) of the Corporations Act to facilitate basic transactional services. The staff in these ADIs do not provide financial advice, only factual information.

89. However, other ADIs offer financial advice about basic banking products, including basic deposit products, general insurance, consumer credit insurance, non-cash payment facilities and first home saver accounts. These ADIs are required to meet the various existing obligations attached to the financial advice regime, such as training requirements.
90. During consultation about the ban on conflicted remuneration, concerns were raised about the significant changes to employee remuneration and workplace arrangements that would have been required were the ban to apply to advice relating to basic banking products. Stakeholders argued that these costs were disproportionate to the potential consumer protection benefits as there was not the same degree of conflict, risk and potential consumer detriment in relation to basic banking products compared with other financial products.

#### *Concerns about application of the best interests duty to basic banking products*

91. The best interests duty attaches to the provision of personal advice, regardless of whether the service is full financial planning or more limited, simple advice which takes into account only some basic personal circumstances.
92. Concerns were raised about the significant compliance costs and impracticalities of applying the best interest duty to personal advice given by an employee of an ADI in relation to that ADI's own basic banking products.
93. Stakeholders argued that application of the best interests duty could, for example, require a staff member to provide advice about a competitor's products (where it better suited to the client's needs) or could require a staff member to take into account, for example, the person's existing financial products prior to provision personal advice about the bank's products. However, in many cases advice is given by frontline staff, such as a teller or bank specialist, and in practice these employees only provide advice on the products offered by the bank, taking into account limited personal information and providing basic product information, such as current interest rate information.
94. In summary, it was argued that the application of a best interests duty in relation to basic banking products would impose significant costs without a corresponding increase in consumer benefits given there was not the same level of conflict, risk or impact in the case of these products compared with other financial products.

#### **Why was Government action required?**

95. Basic banking products are generally considered to be relatively homogenous across institutions and to be low risk. Thus, it is not considered necessary to have a best interests duty apply to these products.
96. As initially announced, a best interests duty and ban on conflicted remuneration would have been introduced via legislation. The only way to provide an exemption for basic banking products from these requirements was a carve-out from the legislation, that is, government action.

### **Objective of Government action**

97. The objective of the government action was to ensure the ban on conflicted remuneration and best interests duty did not apply in cases where there would be a significant cost to industry without a commensurate increase in consumer protection.

### **Options that were considered**

#### *Chosen option: Limited carve-out for basic banking products*

98. This option resulted in advice relating solely to basic banking deposits, where an employee is advising on or selling their employer ADI's product, being fully carved out from the ban on conflicted remuneration and partially carved out from the best interests duty.
99. While this carve-out applies to any ADI employee (whether they provide frontline teller services or financial planning service), given tellers often provide this advice on basic banking products as part of their day to day employment activities, the carve-out is largely intended to address the more routine activities of frontline staff.
100. If an employee of an ADI provides advice on a combination of a banking product and more complex financial products, the carve-out from conflicted remuneration does not apply.
101. Under this carve-out, a modified best interests duty applies to the provision of advice on basic banking products. Specifically, the adviser must have identified the objectives and financial needs of the client, identified the subject matter of the advice being sought and made relevant enquiries into the client's circumstances.
102. After completing these elements, the carve out exempts the adviser from performing the other elements of the best interests duty, which typically require the adviser to assess issues such as whether they have the expertise required to provide the advice and require the adviser to take into account the entirety of the client's circumstances.

103. The Act notes that this carve-out only applies to Australian ADIs and to providers who are an agent or employee of an Australian ADI and that the subject matter of the advice relates to:

- a basic banking product;
- a general insurance product;
- consumer credit insurance; or
- a combination of any of those products;

*Alternative option A: Status quo*

104. This option would have maintained the status quo. It would have meant that the ban on conflicted remuneration and the full best interests duty would have applied to personal advice provided solely in relation to basic banking products.

105. This would have imposed a significant cost to ADIs and potentially consumers (who could no longer receive limited advice on bank banking products from bank employees) without generating a commensurate increase in consumer protection. For these reasons, the ban on conflicted remuneration and the full best interests duty was not applied to basic banking products.

## **ACCESS TO SCALED ADVICE**

- The initially announced FOFA package was intended to facilitate access to scaled advice.
- Scaled advice is financial advice which concerns a limited range of issues, this is opposed to 'holistic' advice which takes into account the entirety of a client's financial needs and situation.

### **Problem**

106. The original FOFA reforms attempted to facilitate the provision of limited or 'scaled' advice. As noted in paragraph 1.34 of the original explanatory memorandum for the *Corporations Amendment (Further Future of Financial Advice Measures)* Bill 2011, the design of the best interests duty is intended to:

'accommodate the provision of limited advice (also referred to as 'scaled advice') that only looks at a specific issue (for example, single issue advice on retirement planning) and 'holistic' advice that looks at all the financial circumstances of the client. In some situations, the client might prefer to receive more targeted advice on a matter that is particularly concerning them rather than comprehensive advice. As long as the provider acts reasonably in

this process and bases the decision to narrow the subject matter of the advice on the interests of the client, the provider will not be in breach of their obligation to act in the client's best interests. The scaling of advice by the provider must itself be in the client's best interests, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances.'

107. Consultation on the exposure draft of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 highlighted that it was unclear whether the best interests duty facilitated access to scaled advice.

#### **Why was Government action required?**

108. As the lack of clarity regarding the application of the best interests duty to scaled advice under the best interests duty represented a form of regulatory failure that arose under the FOFA legislation, government action was required to provide clarity.

#### **Objectives of Government action**

109. The objective of the previous government's action was to make it clear to industry that the best interests duty enabled the provision of scaled advice.

#### **Options that were considered**

##### *Chosen option*

110. The chosen option was to insert a note into the Corporations Act stating that the best interests duty anticipates the use of scaled advice. The following note was inserted after subsection 961B(2) of the Corporations Act:

"The matters that must be provided under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought."

##### *Alternative option: Amendment to Corporations Act*

111. Under this option, there would have been an amendment to the Corporations Act to clarify that the regulatory obligations around the provision of personal advice were scalable and therefore the steps an adviser would need to take in order to comply with these requirements would depend on what was reasonable in the circumstances under which the advice is being provided. For example, a

reasonable person would not consider a request for advice on a specific topic to require inquiries on matters outside of that topic.

112. As the necessary clarity could be achieved through the insertion of a note, rather than amendment to the Corporations Act, this option was not selected.

## Impact Analysis

113. This section considers the impacts of the Regulations on the relevant stakeholder groups and analyses performance against the objective. There are challenges in identifying the specific impacts of each regulation as they were introduced concurrently and as part of a suite of other FOFA reforms. Treasury is, therefore, seeking further information from affected stakeholders in order to inform its impact analysis and regulatory costings.
114. No formal reviews of the regulations have taken place, apart from this PIR, although the Australian Securities and Investments Commission continue to monitor the FOFA reforms.

### **BAN ON CONFLICTED REMUNERATION (UP-FRONT AND TRAILING COMMISSIONS AND LIKE PAYMENTS) FOR INDIVIDUAL AND GROUP LIFE RISK INSURANCE WITHIN SUPERANNUATION**

#### **Baseline Case:**

115. The baseline case is the previous regulatory regime in which there was no ban on conflicted remuneration.

#### **How the Regulation was implemented**

116. The government implemented a ban on conflicted remuneration for individual and group life insurance within superannuation.

#### **Impacts of the regulation on stakeholders**

117. Given the regulation was introduced at the same time as a number of other reforms, there are difficulties with isolating the impacts of specific Regulation.
118. However, Treasury considers:
- The policy would have imposed some costs on financial advisers who would have lost access to a source of remuneration, resulting in lower profits for some advisers or even some advisers exiting the market.
  - Consumers would have been the main beneficiaries of the policy as the ban on conflicted remuneration would have created better alignment between advisers' incentives and consumer interests. The removal of a conflict of interest would, therefore, contribute to increased trust and confidence in financial advisers and the financial system more generally.

- The regulatory costs for businesses to implement this option were low as the regulation did not require a change in existing business practices.

#### **Whether the regulation has met its objectives**

119. While it is difficult to draw definite conclusions given the fact this Regulation was introduced as of a number of other related reforms, the Treasury considers that the Regulation has been effective in meeting its objective. While the Regulation has removed a source of remuneration for advisers, Treasury considers these costs have been outweighed by the benefits to consumers of increased consumer protection, through the removal of a potential conflict of interest and consequent increased trust and confidence in advisers and the financial system more generally. The risk of regulatory arbitrage exists under this regulation as advisers may seek to move customers inside super to outside of super so that they can receive commissions and other benefits. However given the significant costs and risks associated with this action, treasury does not expect this practice to be widespread or systematic.
120. Treasury therefore considers that the Regulation should continue in its current form.

#### Consultation questions

- Has the regulation achieved its intended objective?
- Were there impacts on business other than those identified?
- Were there impacts on consumers other than those identified?
- What were the compliance costs of the announced measures? These costs may include but are not limited to:
  - Designing new IT systems
  - Training around new compliance requirements
  - Designing new remuneration systems
- Do you have any concerns or comments regarding the impact and operation of the regulation?
- What are your views regarding the regulatory option chosen by the Government compared to the alternative options which the Government could have pursued? What are the key costs and benefits of these alternative options compared to the chosen option?

## **REQUIREMENT FOR ADVISERS TO RENEW CLIENT AGREEMENT TO ONGOING ADVICE FEES EVERY TWO YEARS (OPT-IN)**

### **Baseline Case**

121. The baseline scenario considered is a yearly opt-in requirement [as this was what was originally announced].

### **How the Regulation was implemented**

122. The government implemented a two yearly opt-in requirement.

### **Impacts of the regulation on stakeholders**

123. The main impacts of the regulation have been the requirement to prepare notifications to clients requiring them to confirm their agreement to the ongoing fee arrangements. Therefore, the regulatory costs of this option are the costs associated with preparing renewal notices.
124. Treasury has had regard to a number of different sources of information in calculating the regulatory costs of this regulation:
- Research prepared by Associated Advisory Practices indicated that each renewal notice could take up to 1 to 2 hours to prepare at a cost of between \$110 and \$220 per client annually;
  - According to separate research undertaken by Aon Wealth Management Ltd for the Financial Planning Association, each renewal notice could cost between \$106 and \$171.63 per client, depending on whether the client was 'actively' or 'passively' serviced.<sup>7</sup>
125. Treasury considers that for a practice with 750 clients (with 250 and 500 clients actively and passively serviced respectively) and based on the AON estimates; this would amount to costs of \$95,906.25 annually, assuming a notice is required to be sent every year.

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<sup>7</sup> It is not unusual for clients in some practices to receive varying levels of service depending on the fees they are paying to their adviser. For example, a high net-wealth client paying large ongoing fees is more likely to be 'actively' serviced – this might involve routine client reviews at the instigation of the adviser, whereby the contact between the adviser and client is frequent. On the other hand, some 'passively' serviced clients are less likely to have regular reviews with their adviser than their 'actively' serviced counterparts, often because they are paying for a lower level of service. Many stakeholders have argued to Government that it is the lower fee-paying, 'passively' serviced clients that will be harder to get to opt-in due to the less frequent contact in the adviser-client relationship.

126. Costs per client may differ due to factors such as firm size. For example, smaller boutique practices with fewer clients, or large institutional practices with thousands of clients, will incur differing costs in order to comply with the policy.
127. However the legislation specifies that notices are to be sent every two years, therefore for a two year renewal notice this would then amount to \$47,953.12 annually.
128. According to Rice Warner, in its research commissioned by the Industry Super Network, the overall cost of an opt-in regime to a 'typical' dealer group of advisers, is estimated at \$110,000 as an initial outlay, and \$105,000 ongoing. For a 'typical' product provider, it would involve an initial outlay of \$1.4 million and \$450,000 ongoing. However, the Rice Warner report, in coming to its estimate, excluded small dealer groups (outside the top 100 firms) from its forecasts. The basis for this was that smaller advice firms would incur only modest costs due to being able to rely on external support service providers.
129. Although the entities commissioning this research (AON and Associated Advisory Services) take different views about the costs being incurred by industry, their estimates appear consistent with one another.

### **Whether the regulation has met its objectives**

While it is difficult to draw definite conclusions given the fact this Regulation was introduced as of a number of other related reforms, the Treasury considers that the Regulation has been effective in meeting its objective. While the Regulation has imposed significant regulatory costs on industry, Treasury considers these costs have been outweighed by the benefits to consumers, by providing an opportunity for consumers to re-assess whether existing fee arrangements represent value for money and by eliminating cases of 'nil' advice where fees are being charged without any advice being provided.

Treasury therefore considers that the Regulation should continue in its current form.

## Consultation questions

- Has the regulation achieved its intended objective?
- Were there impacts on business other than those identified?
- Were there impacts on consumers other than those identified?
- What were the compliance costs of the announced measures? These may include but are not limited to:
  - Designing and issuing renewal notices
  - Training around new opt-in requirements and compliance
  - Creating new IT systems to deal with opt-ins and outs
- Do you have any concerns or comments regarding the impact and operation of the regulation?
- What are your views regarding the regulatory option chosen by the Government compared to the alternative options which the Government could have pursued? What are the key costs and benefits of these alternative options compared to the chosen option?

## **BAN ON SOFT DOLLAR BENEFITS OVER \$300**

### **Baseline Case**

130. The baseline case considered is that there is no ban on soft dollar benefits, with advisers required to manage any potential conflicts of interest through disclosure.

### **How the Regulation was implemented**

131. The government implemented a ban on soft dollar benefits over \$300.

### **Impacts of the regulation**

132. Given the regulation was introduced at the same time as a number of other reforms, there are difficulties with isolating the impacts of specific regulation.

133. However, Treasury considers:

- The policy would have imposed some costs on financial advisers who would have lost access to a source of remuneration, resulting in lower profits for some advisers or even some advisers exiting the market.
- Consumers would have been the main beneficiaries of the policy as the ban on soft dollar limits over \$300 would have removed a potential conflict of interest and created better alignment between advisers' incentives and consumer

interests. This would be expected to contribute to increased trust and confidence in financial advisers and the financial system more generally.

- The compliance costs for businesses to implement this option were low as the regulation did not require a change in existing business practices.

### **Whether the regulation has met its objectives**

While it is difficult to draw definite conclusions given the fact this Regulation was introduced along with a number of other related reforms, the Treasury considers that the Regulation has been effective in meeting its objective. While the Regulation has removed a source of remuneration for advisers, Treasury considers these costs have been outweighed by the benefits to consumers of increased consumer protection, through the removal of a potential conflict of interest and consequent increased trust and confidence in advisers and the financial system more generally.

Treasury therefore considers that the Regulation should continue in its current form.

#### Consultation questions

- Has the regulation achieved its intended objective?
- Were there impacts on business other than those identified?
- Were there impacts on consumers other than those identified?
- What were the compliance costs of the announced measures? These may include but are not limited to:
  - Training on the new regulatory requirements
  - Designing IT systems to report and classify benefits
  - Creating new remuneration structures in the absence of these benefits
- Do you have any concerns or comments regarding the impact and operation of the regulation?
- What are your views regarding the regulatory option chosen by the Government compared to the alternative options which the Government could have pursued? What are the key costs and benefits of these alternative options compared to the chosen option?

## **LIMITED CARVE-OUT FOR BASIC BANKING PRODUCTS FROM THE BAN ON CONFLICTED REMUNERATION AND THE BEST INTERESTS DUTY**

### **Baseline Case**

134. The baseline case corresponds to a situation where there is no carve-out for basic banking products from the conflicted remuneration structures and best interests duty. This implies that basic banking products are fully covered by this legislation.

### **How the Regulation was implemented**

135. The government implemented a carve-out for basic banking products from the ban on conflicted remuneration and the best interests duty.

### **Impacts of the regulation**

136. The regulation essentially preserved the status quo (that is, ensured that advice provided in relation to basic banking products did not become subject to the ban on conflicted remuneration or the best interests duty). In this regard, the regulation itself did not have any impacts on stakeholders.

### **Whether the regulation has met its objectives**

137. While the regulation did not have any impacts on stakeholders, in assessing whether it has met its objectives, it is necessary to have regard to the impacts that would have arisen were the limited carve-out not implemented. As noted in the discussion of alternative options considered, if a ban on conflicted remuneration and full best interests duty were applied to personal advice provided in relation to basic banking products it would have imposed a significant cost on ADIs and their employees without a commensurate benefit to consumers.
138. Treasury therefore considers that the Regulation should continue in its current form.

## Consultation questions

- Has the regulation achieved its intended objective?
- Were there impacts on business other than those identified?
- Were there impacts on consumers other than those identified?
- What were the compliance costs of the announced measures? These may include but are not limited to:
  - Training for line staff on their responsibilities in regards to the best interest duty
  - IT System development
  - Additional training required to allow staff to give advice on basic banking products
- Do you have any concerns or comments regarding the impact and operation of the regulation?
- What are your views regarding the regulatory option chosen by the Government compared to the alternative options which the Government could have pursued? What are the key costs and benefits of these alternative options compared to the chosen option?

## **ACCESS TO SCALED ADVICE**

### **Baseline Case**

139. The baseline case is where there is considerable uncertainty around whether ADI's can remain compliant with the best interests duty and still provide scaled advice. Many institutions were concerned about whether the provision of scaled advice puts them at risk of not staying consistent with the best interests duty.

### **How the Regulation was implemented**

140. The government legislated a note to make it clear how the best interests duty was intended to apply in relation to scaled advice.

### **Impacts of the regulation**

141. The regulation did not result in any compliance costs. It provided additional certainty to industry regarding the operation of the best interests duty in relation

to scaled advice and in doing so, ensured that the FOFA reforms did not inadvertently restrict the provision of scaled advice. The regulation did not have any impacts on consumers and ensured that there was the same level of access to scaled advice, thereby maintaining consumer choice.

### **Whether the regulation has met its objectives**

The regulation increased certainty for industry without any noticeable costs to industry or consumers.

Treasury therefore considers that the regulation should continue in its current form.

#### Consultation questions

- Has the regulation achieved its intended objective?
- Were there impacts on business other than those identified?
- Were there impacts on consumers other than those identified?
- What were the compliance costs of the announced measures?
- Do you have any concerns or comments regarding the impact and operation of the regulation?
- What are your views regarding the regulatory option chosen by the Government compared to the alternative options which the Government could have pursued? What are the key costs and benefits of these alternative options compared to the chosen option?

Treasury appreciates input from stakeholders in creating these impact statements and costings. Stakeholders are invited to provide feedback on the regulatory impact of the reforms, including the impact of the factors identified above, as well as any additional factors. If there are any issues or comments on this PIR please do not hesitate to contact Treasury.