TREASURY EXECUTIVE MINUTE

Minute No. 20111249

19 April 2011

Assistant Treasurer and Minister for Financial Services and Superannuation

cc: Deputy Prime Minister and Treasurer

FUTURE OF FINANCIAL ADVICE REFORMS - APRIL 2011 ANNOUNCEMENT

Timing: As soon as possible; to enable the Treasurer and Prime Minister to approve the measures prior to announcement in late April 2011.

Recommendation/Issue: That you:

- Approve the measures outlined at Additional Information, subject to clearance of the Regulation Impact Statements (Attachment D) by the Office of Best Practice Regulation; and

Approved/Not Approved Signature: …../…../2011

- Sign the letters at Attachments B and C to seek policy approval from the Prime Minister and Treasurer for the measures.

Signed/Not Signed Signature: .... …../…../2011

KEY POINTS

- Since the announcement of the Future of Financial Advice (FOFA) reforms in April 2010, key details of the reforms have been the subject of implementation consultation. You also recently met with select industry and consumer groups to discuss these details.
- We understand you will announce certain key aspects of the reforms in late April, as well as update stakeholders on progress in other areas of FOFA. The measures that we are seeking agreement to are set out at Additional Information (with further detail at Attachment A).

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Contact Officer: Ext:

General Manager, Corporations and Financial Services Division

ADDITIONAL INFORMATION

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Operation of the statutory best interests duty

- This duty will require a person when providing personal advice to a retail client to act in the best interests of the client and give priority to the client's interests. s47C

  (see further section 2 of Attachment A).

Operation of 'opt-in' under the adviser charging regime

- Advisers will have to seek their clients' renewal to ongoing advice fees (by opting in) every two years, rather than every year as was originally announced. Every second year where compulsory renewal is not applicable, there will be a compulsory disclosure notice provided to the client outlining information normally included in the renewal notice (such as fee information) (see further section 3 of Attachment A).

Ban on volume payments (comprehensive ban)

- A prohibition of any form of payment relating to volume or sales targets from any financial services business, relating to the distribution and provision of advice for retail financial products, including those from platform providers to financial advisory dealer groups. This represents a broad ban on volume-based payments, targeted at removing payments that have similar conflicts to product provider set remuneration, such as commissions (see further section 4 of Attachment A).

Accountants licensing exemption

- Removal of the existing licence exemption for accountants providing advice on self managed superannuation funds. The Government is working to facilitate streamlined entry of accountants into the AFSL regime in a low cost way that recognises their existing skills and experience. This will replace the existing licence exemption for accountants (see further section 5 of Attachment A).

Limited carve out of basic banking products from conflicted remuneration structures and best interests duty

- A limited carve out from elements of the ban on conflicted remuneration structures and best interests duty for basic banking products where employees of an Australian Deposit-taking

Institution (ADI) are advising on and selling their employer ADI basic banking products. Basic banking products are basic deposit products (e.g. savings accounts), First Home Saver Account (FHSA) deposit accounts and non-cash payment products (e.g. cheque accounts, travellers cheques) (see further section 6 of Attachment A).

Ban on soft dollar benefits

- A prospective ban on soft dollar benefits, where a benefit is $300 or more (per benefit) from 1 July 2012, and is provided or made available to a licensee, platform or representative from one third party source. Benefits received which do not exceed $300 per benefit will be allowed subject to an 'infrequent or irregular test for identical or similar benefits'. The ban does not apply to any benefit provided for the purposes of professional development and administrative IT services provided set criteria is met (see further section 7 of Attachment A).

Access to advice

- The Government will work to improve access to advice through the establishment of greater guidance on scaling advice both inside and outside of superannuation and introducing legislative clarity that advice can be scaled. Intra-fund advice will be carved out of the FOFA adviser charging regime in accordance with the Stronger Super recommendations (see further section 8 of Attachment A).

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ATTACHEMENT A

1. Application of the ban on conflicted remuneration to risk insurance

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– We note that the United Kingdom has refrained from a full-scale ban on commissions in relation to risk products as part of its *Retail Distribution Review*.

- Treasury has undertaken extensive consultation on the treatment of risk insurance commissions since the beginning of 2011 as intended.

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- We previously briefed you on the treatment of insurance commissions outside of superannuation and the outcome of industry consultations on insurance (see **Executive Minute No. 2011/0477**).

- We provided your office with information on 18 March 2011 on the potential treatment of insurance commissions offered through superannuation, s47C

2. Operation of the statutory best interests duty

- Under the FOFA reforms, the Government announced that it would introduce a statutory best interests duty for financial advisers. This duty would require advisers to act in the best interests of clients and give priority to the interests of the client above any other interests. The Government also indicated that the duty would include reasonable steps qualification so that advisers are only required to take reasonable steps to discharge the duty.
  - The Government indicated that it would consult on the detail of the best interests formulation and the reasonable steps qualification.
- Following consultation with stakeholders, Treasury recommends to formulate the best interests duty as one that will require a person when providing personal advice to a retail client to act in the best interests of the client and, if there is a conflict between the client's interests and the interests of the:
  - person providing personal advice; or
  - the providing entity, to the extent that the person has knowledge of the interests of the providing entity,

  to give priority to the client's interests.

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- It is not considered reasonable for a person in the giving of personal advice to be required to assess all products on the market or a subset of the market to find the best possible product for the client, unless this service is offered by the person or requested by the client and subsequently agreed to by both parties. This is consistent with the duty not being a duty to give the 'best advice' as outlined above.
- A person providing personal advice cannot contract out of this duty. If a person considers that they cannot provide advice that is in the best interests of the client in accordance with this duty, they must refuse to provide the advice.
- Liability for any breach of the duty will rest with the relevant providing entity. However, the person who provided the advice may be subject to administrative penalties in the form of a banning order.

Other issues

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ATTACHEMENT A

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3. Operation of 'opt-in' under the adviser charging regime

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- A two year opt-in would place a requirement on advisers to renew their clients' agreement to ongoing fees every second year. Features of the policy would include:
  - The adviser being 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;
  - If the client is unresponsive to the renewal notice, the adviser can continue charging the client for an additional 30 day 'grace period';
  - Every second year where no compulsory renewal is required, an annual disclosure document would be required to be sent in its place, containing the same information normally contained in the annual renewal notice (for example, fee information); and

– If a client does not respond to a compulsory renewal notice, they are taken to have chosen to opt-out, 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 advice services already rendered to the client).

- Only those advisers intending to charge ongoing advice fees to retail clients need to send the notice. s47C

: As part of the Government's announcement, we recommend noting that consultation with industry on potential penalties, including the need for a penalty, will be ongoing.

- Treasury has consulted extensively on this issue, having met with a range of stakeholders since the April 2010 announcement.

– Most product manufacturers and financial advisory groups are opposed to opt-in, arguing it is unnecessary (because clients can opt-out) and will impose administrative costs of adviser (which will be passed onto clients).

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4. Ban on volume payments

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- Parts of industry put forward a model for a narrow ban on volume payments, whereby platform providers could pay scale rebates to dealer groups in certain circumstances. This will not be permissible under a broad ban.

- This will mean that, as part of the Government's ban on conflicted remuneration, there will be a prohibition of any form of payment relating to volume or sales targets from any financial services business, relating to the distribution and provision of advice for retail financial products, including those from platform providers to dealer groups.
- This represents a broad ban on volume-based payments, targeted at removing payments that have similar conflicts to product provider set remuneration, such as commissions.
- The ban is intended to prevent any licensee, authorised representative or adviser from receiving a payment from any entity based on volume of product sales. As such, anti-avoidance provisions will apply to prevent arrangements such as equity share schemes or special purpose vehicles from being used to circumvent the ban on volume-based payments.
- This would include a ban on the receipt of a volume-based payments from any entity, through any direct or indirect means, including from dividends or soft dollar payments.

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Scope of the ban

- For clarity, the ban will include a prohibition on the following payments:
  - Any volume-based payment from a product provider, platform provider, or any other entity to a licensee, authorised representative or adviser in relation to the distribution or advice for retail financial products;
  - Any volume-based payment by the product provider, platform provider or any other entity to the licensee or adviser which is generally conditional on the licensee having

large funds under management with the product (except asset-based fees paid by a client to a licensee or adviser);

- Any volume-based payment from licensees to their employee advisers or authorised representatives for distribution of retail financial products, contingent or based on meeting sales targets;

- Any volume-based shelf-space fees which are paid form the fund manager to the platform provider and from the platform provider to the licensee; and

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Note: This ban will **not** apply in relation to risk insurance, or where employees are advising on and selling their employer's basic deposit products **only**.

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5. Accountants' licensing exemption

- Last year, the Government announced that the existing exemption permitting accountants to provide advice on the establishment and closing of self-managed superannuation funds without holding an Australian Financial Services Licence (AFSL) would be removed and the Government would consult on an appropriate replacement.

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ATTACHEMENT A

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To this end, a working group involving ASIC, Treasury and the accounting bodies has been established and is developing a cost-effective way to bring accountants wishing to provide financial advice into the AFSL regime. Detailed consultations are ongoing and all parties are committed to achieving a workable outcome.

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- It will be necessary to consider giving accountants wanting to apply for an AFSL appropriate transitional periods to assist accountants moving into the regime. Further consultation is required on this issue.

- Treasury will report to Government on the outcome of these consultations at the end of May.

6. Limited carve out of basic banking products from conflicted remuneration structures and best interests duty

- In **Executive Minute 2011/1045**, the issue of the application of the ban on conflicted remuneration to employee performance pay for advising on financial products was considered. The minute noted the benefits of a potential carve out of basic banking products from the ban on employee bonuses and the best interests duty.
- s47C it would involve a limited carve out from elements of the ban on conflicted remuneration structures and best interests duty for basic banking products where employees of an Australian Deposit-taking Institution (ADI) are advising on and selling their employer ADI basic banking products. Basic banking products are basic deposit products (e.g. savings accounts), First Home Saver Account (FHSA) deposit accounts and non-cash payment products (e.g. cheque accounts, travellers cheques etc).[1]
  - It is a carve out that applies in relation to both general and personal advice (while the best interest duty is only relevant to personal advice; the ban on conflicted remuneration structures applies to both general and personal advice).
- In effect, the exemption allows existing distribution arrangements of basic retail banking products to continue, which often involves frontline staff selling their employer's product. Current employee remuneration which may involve bonuses based on sales targets will continue. Importantly, if ADI staff provide advice on a combination of basic banking products and other more complex financial products, the carve-out will no longer apply.

While executive minute (**EM 2011/1045**) includes a full discussion of the issues, scope of carve out and sensitivities, summary key points are included below.

- Fully-fledged financial planners advising on their employer's products (for example a salaried financial planner within a bank) would not be able to receive any sales bonuses or 'internal' commissions whatsoever where they are advising on complex products or a combination of basic banking products and more complex products.
- Staff selling their employer's product would be able to continue receiving sales bonuses or 'internal' commissions for basic banking products. A 'basic banking product' is a deposit account (e.g. saving accounts), FHSA deposit accounts and non-cash payment product (e.g. cheque accounts and travellers cheques).
- The same approach would apply to the best interests duty. That is staff selling their employer ADI's basic banking products would not need to comply with the best interests duty. However staff would need to comply with the duty if they offered advice on a combination of the employer ADI's basic banking products and other more complex financial products.
- The context for the carve out is that frontline bank/building society staff (e.g. tellers and specialists) often receive bonuses for reaching certain targets for the sale of these basic banking products. The staff may also provide limited personal advice, i.e. taking into account

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[1] This reflects products which are tier 1 products (other than insurance). Under ASIC's regulatory framework (RG 146), there are different training requirements for advice in relation to tier 1 and 2 products.

the savings held by a customer in an everyday transaction account before recommending a high interest savings account. To ban this activity would result in a fundamental shift in the way these institutions distribute the products.

- The rationale for the carve out is that we have received no particular evidence of customer detriment of large scale misselling of these products, nor was it envisaged that FOFA was aimed at addressing standards in this part of the sector. Further these products are generally easy to understand and consumers also generally understand that frontline staff are in the business of selling their employer's products.

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7. Ban on soft dollar benefits

- s47C announce a prospective ban on soft dollar benefits over $300 (that is $300 or more) from 1 July 2012, with a carve out for professional development.
- We note that the announced ban on conflicted remuneration structures did not initially extend to soft dollar benefits. The expert advisory panel, in its review of ethical standards, was to consider whether these payments are consistent with those standards. The panel has discussed issues relating to soft dollar benefits and noted some of those deliberations in its report to you dated 15 March 2011 s47C The panel was due to report on these issues to you by the end of this year. s47C

The announced form of the soft dollar ban could include:

- A prospective ban on soft dollar benefits, where a benefit is $300 or more (per benefit) from 1 July 2012, and is provided or made available to a licensee, platform or representative from one third party source. Benefits received which do not exceed $300 per benefit will be allowed subject to an 'infrequent or irregular test for identical or similar benefits'. The ban does not apply to any benefit provided for the purposes of professional development and administrative IT services provided set criteria is met.
  - We have suggested that an exemption also be provided for administrative IT services (for example to allow the provision of software to access a platform) to facilitate access to advice.

– We have suggested that benefits below $300 are subject to an ‘infrequent or irregular test for identical or similar benefits’ to ensure that small similar benefits are not given on a repeated basis.

– We suggest further details of the ban be subject to implementation consultation, including the criteria for the exemptions for professional development and administrative IT services. Criteria for professional development could include a domestic criteria as well as criteria to ensure the majority of the time at the conference is spent on professional development activities.

- The ban on soft dollar would apply from 1 July 2012, consistent with the commencement of other FOFA reforms relating to conflicted remuneration.

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Below are some examples of the operation of the ban (this is not an exhaustive list):

Issue	**Banned?**	**Why?**
Free or subsidised business equipment or services, such as computer hardware, office rental and commercial software, over $300.	Yes	These benefits have the potential to influence product selection and decision making.
Access to administrative information technology services, such as software to access a platform or access to a website to place orders.	No	So long as it can be shown that the administrative information technology services is relevant and tangible to the licensee's business, this is a benefit that will be permitted as it facilitates access to advice.
Entertainment and gifts over $300.	Yes	Entertainment and gifts over this threshold may potentially influence advice.
Conferences, seminars and training conducted in Australia where a set percentage of time is spent on education.*	No	It is important that licensees and representatives continue to increase their professional standards and development, and training can play an important role in this regard.
Conferences, seminars and training conducted overseas. *	Yes	Overseas conferences may appear to be inappropriate and an unnecessary expense for the purpose of training.

*subject to a domestic criteria being adopted for the professional development exemption.

Implementation consultation could consider things like:

- Criteria for the exemption for professional development, such as a domestic criteria (i.e. training cannot be conducted overseas) with a requirement for the majority of time at the conference to be spent on training. It throws up a number of technical details, for example how is ‘majority time’ at a conference to be calculated – if 85% of time was needed to be

spent on training - is this calculated per day, per conference, confined to business hours, how evening events are treated and so forth. It will also raise issues about whether the incidental costs to attend the training are covered (e.g. flights, food and entertainment).

- Whether exempt benefits are subject to other requirements, such as disclosure or record keeping. At this stage, our preliminary view is that we would only seek disclosure of the more substantive benefits that are exempt – that is the carve out for professional development and administrative IT services.
- Interaction with the best interests duty – our current view is that the receipt of each exempt benefit does not need to be tested against the best interest duty (i.e. separate consideration of whether the benefit can be accepted each time it is received) but when providing personal advice, the adviser will need to ensure that the fact they have received that benefit does not bring them into conflict with the client's interest (the adviser must prefer the client's interest) and therefore the benefit cannot adversely affect the advice given. If the advice was affected adversely by the exempt benefit, an advisor may breach the best interests duty.
- The valuation of non-monetary benefits – this could be based on the cost to the entity of providing the benefit or fair value.

Other issues may be raised by industry during implementation consultation.

Some general considerations:

- There is no industry-wide definition of soft dollar and industry currently approaches the issue differently.
- The broadest definition is used in ASIC Report 30 which defines it as 'all benefits received by a firm or its representatives or associates, other than basic commissions or direct client advice fees'. This includes some monetary payments as well as non-monetary benefits.
  - Under the current framework, an adviser must disclose these benefits in a Statement of Advice if they may be capable of influencing that specific advice. Licensees must also have arrangements in place to manage conflicts of interest.
- Alternatively, the FSC/FPA alternative remuneration code define it as 'certain material benefits (other than commissions or advice fees) provided or made available to a licensee, platform or representative from a third party that may influence or be perceived to influence the choice and use of the service or product of the third party'. Here, the FSC/FPA code rely on the $300 monetary limit to determine 'materiality' but also rely on an 'influence' factor.
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  It would cover any benefit that is monetary or non-monetary. Any threshold selected is arbitrary but we note that $300 is the current level in which a benefit is deemed to be 'material' under the FSC/FPA alternative remuneration code (of course the consequence of the FSC/FPA code is that the benefit[2] must be disclosed in a

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[2] It should be noted that some benefits are prohibited under the FSC/FPA alternative remuneration code, such as payments based on volume of business.

register which is publicly available on request). An irregular or infrequent benefit (which are identical or similar) under $300 is also treated as a minor benefit for the purposes of fringe benefits and is exempt.

- The 'infrequent or irregular test for identical or similar benefits' is designed as a measure to avoid similar benefits under $300 being provided on a regular basis.
- There are proposed carve outs for professional development and administrative IT services (e.g. software to access a platform). Criteria around these exemptions should be considered, i.e. to ensure that the conference is largely for the purposes of professional development and not allow the exemption to become a de-facto soft-dollar benefit.
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8. Access to advice

FOFA Reforms

- Last year, the Government announced that the existing package which provides for simple advice within a superannuation fund (known as intra-fund advice) will be extended into new areas including, for example, transition to retirement, intra-pension advice, nomination of beneficiaries, superannuation and Centrelink payments, and retirement planning generally.
  - In addition, the Government indicated that it would review whether other measures are needed to clarify whether simple advice can be provided in a compliant manner outside of superannuation.
- In response to this, Treasury recommends a two-pronged approach to expanding the availability of financial advice.
  - The first prong involves new regulatory guidance on how to scale financial advice both inside and outside of superannuation. This guidance would cover the areas identified above. This guidance will be developed and issued by ASIC. It is envisaged that this guidance will be in place by the end of 2011.
  - The second prong involves amending the existing legislation that governs provision of personal advice to clarify that limited scope or scaled advice can be provided.
- In relation to the regulatory guidance, ASIC has indicated it plans to consult on providing new regulatory guidance about scaling advice (that is, how to scope advice in a way that meets client needs and expectations and what type of inquires would be needed in such cases). ASIC's proposed consultation will include examples of how scaled advice can be provided under the existing and proposed law without any ASIC relief. It is envisaged that this guidance would cover the existing intra-fund advice topics as well as the additional topics

identified above. ASIC also plans to consult on providing further regulatory guidance on the distinctions between the key legal categories of factual information, general advice and personal advice.

– This guidance may eventually replace Regulatory Guide 200 *Advice to super fund members*.

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Stronger Super Reforms

- The Government has also committed in the context of the Stronger Super package of reforms to establishing specific rules around the provision of advice in the superannuation context.

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9. Restriction of the term financial planner

- Some parts of the financial advice industry have argued that the term 'financial planner' should be defined in the Corporations Act and its use restricted. It is argued that this would carry consumer protection benefits, including that consumers would have a clear understanding of whether an adviser has met certain educational and professional standards.

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10. Updates on other areas of FOFA

- The FOFA reforms also include the simplification of disclosure of advisory services provided to consumers, enhancement to ASIC's licensing and banning powers, definition of sophisticated/unsophisticated investor and an expert review of the need for a statutory compensation scheme.
  - The simplification of disclosure documents is underway but will not be finalised until the detailed requirements of reforms are settled. Regulations to support the simplified FSG will be in place by 1 July 2012.
  - The announced changes to ASIC's licensing and banning powers will be included in the exposure draft of legislation implementing the reforms. s47C
  - In relation to the wholesale/retail review, a consultation paper has been released and around 45 submissions were received. Treasury is progressing options in response to the paper for the Minister's consideration,
  - A consultation paper by Richard St John on the need for a statutory compensation scheme is due to be released shortly.
    - : The next steps in the review are to consider submissions, undertake further stakeholder engagement and prepare a final report s22 s22

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Regulation impact statement: Access to Advice

Problem

1. Research indicates that only 20 to 40 per of Australia‘s adult population use or have used a financial adviser.[1] Despite this, there is an increasing expectation on individual consumers and investors to make active financial decisions and there is growing complexity of financial products and disclosure documents. This means that many people who do not make use of professional financial advice are likely to achieve better outcomes for themselves and their families if they did access this service.

2. The reasons why Australians are not seeking financial advice are numerous – the major ones generally relate to a lack of engagement with financial matters and a perception that financial advice is not necessary. These matters cannot be addressed through regulatory change unless the use of an advisor is to be compelled. However, a significant proportion (21 per cent) of people who do not seek advice cite concerns over the cost of obtaining advice.[2] To the extent that compliance with regulatory obligations is forcing up the cost of advice, then regulatory change can, to some extent, help address this issue.

3. In addition, research indicates that a large proportion of people, particularly amongst those that do not currently seek advice, prefer piece-by-piece (commonly referred to as _scaled advice‘) advice rather than a comprehensive financial plan (commonly referred to as _holistic advice‘). In particular, 37 per cent of people

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[1] Survey results reported in *Access to financial advice in Australia*, ASIC, Report 224, page 14. Available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep224.pdf/$file/rep224.pdf.
[2] Survey results reported in *Access to financial advice in Australia*, ASIC, Report 224, page 14. Available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep224.pdf/$file/rep224.pdf.

who have never used an adviser prefer to seek their advice this way.[3]

4. Industry has raised questions about the ability of advisers to give this form of advice in a manner that complies with regulatory requirements. The current regulations for providing personal advice require the adviser to make client inquiries that are relevant to the advice (the research obligation—_know your client'), to consider and investigate the subject matter of the advice (the consideration obligation); and to ensure that the advice is appropriate for the client's situation (the appropriateness obligation).

5. The industry argues that there is a great deal of uncertainty concerning a number of factors. These factors include: the level of detail required in a Statement of Advice (SOA), or the need to produce an SOA at all; how the appropriateness obligation and the _scaleable' concept apply to simple personal advice (for example, can you give advice on just one aspect of the client's affairs?); the extent of inquiries required under the _know your client' rule; the line between personal and general advice (that is, a provider might like to give more assistance via a general advice model, but might be reluctant due to the risk of over stepping into personal advice); and the training standards required for personal advice.

6. As noted in a recent ASIC report, only 27 per cent of financial advice providers surveyed promote the availability of scaled advice to their clients.[4] If advisers had more confidence that this form of advice could be provided in a way that complies with their regulatory requirements, they would be more willing to offer this form of advice in the market.

Existing measures to promote scalable advice

7. In order to facilitate greater provision of scalable advice, some regulatory relief and guidance is already in place to assist in the provision of this form of advice mainly in the superannuation

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[3] Survey results reported in *Access to financial advice in Australia*, ASIC, Report 224, page 22. Available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep224.pdf/$file/rep224.pdf.

[4] Survey results reported in *Access to financial advice in Australia*, ASIC, Report 224, page 35. Available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rep224.pdf/$file/rep224.pdf.

context. This form of advice is commonly referred to as ‗intra-fund advice'.

8. The initial foundation for intra-fund advice was established through ASIC Class Order relief (CO 09/210) supplemented by ASIC regulatory guidance (RG200). The ASIC Class Order applies to advice that relates to the member's interest in the fund and does not relate to any other financial product. Under this Class Order, if a superannuation trustee provides this advice, they are exempt from the obligation under the Corporations Act to have a reasonable basis for the advice. The Class Order does not seek to limit who can provide this advice, but only to make it easier for superannuation trustees to provide it.

9. The regulatory guidance provided advisers with details on effective and tailored ways to provide intra-fund advice that still complies with their regulatory obligations on specific topics:

- Making additional contributions to superannuation;
- A person's level of insurance coverage in superannuation;
- A person's investment option in superannuation; and
- Accessing superannuation on the grounds of financial hardship.

10. These specific topics identified in the regulatory guidance do not mean that intra-fund advice can only relate to these four topics. Intra-fund advice can relate to any topic that fits within the definition in the Class Order. However, these four topics are probably the most common intra-fund advice topics.

11. Over time, superannuation trustees have found that it is more cost-effective to provide financial advice on intra-fund related topics through outsourced financial advice specialists rather than financial advisers employed within the fund. In these cases, because the advice is not provided by the superannuation trustee, the exemption in the Class Order is not strictly needed. s47C

For this reason, it has become common industry practice to refer to any advice that is arranged by the superannuation trustee for a member (where internally or outsourced) to be intra-fund advice.

12. While usage of the Class Order relief is not high, industry has indicated that they continue to find the regulatory guidance of use. However, advisers outside of the superannuation context have expressed concerns that this guidance is limited solely to superannuation advice. In particular, they believe similar guidance should be made available on a broader range of non-superannuation advice issues to help promote access to advice more broadly and ensure a consistent framework governing the provision of advice both inside and outside of superannuation.

Objectives of Government action

13. In order to further address issues with access to advice, the Government announced as part of the Future of Financial Advice reform package in April 2010 that:

―The existing package which provides for simple advice within a superannuation fund (known as intra-fund advice) will be extended to new topics to facilitate simple, single issue, personal advice in a compliant matter. This includes extensions to, for example, 1) transition to retirement, 2) intra-pension advice, 3) nomination of beneficiaries, 4) superannuation and Centrelink payments and 5) retirement planning generally.”

14. In recognition of the concerns expressed by industry about the lack of measures to promote scalable advice outside of superannuation, the Government also indicated that ―there will be a review of whether other measures are needed to clarify whether simple advice can be provided in a compliant manner outside intra-fund advice”.

15. The objective of Government action in this area is to facilitate improved access to financial advice particularly through greater provision of scaled advice that is suitable for the client. It would be desirable for any reform in this area to also assist in establishing a consistent regulatory framework across all forms of financial advice.

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Consultation

32. The issue of how to implement the announced expansion of intra-fund advice has been canvassed in some detail at the Future of Financial Advice Peak Consultation Group (PCG) meetings. The PCG is the primary forum through which the Government has consulted with industry on the implementation details of the FOFA reforms.

33. The PCG includes a broad range of stakeholders including industry (Association of Financial Advisers, Financial Planning Association, Financial Services Council, Australian Financial Markets Association, Industry Super Network, Association of Super Funds of Australia, Australian Bankers Association, Law Council of Australia, the professional accounting bodies, Australasian Compliance Institute, Insurance Council of Australia, National Insurance Brokers Association, Abacus and Self-Managed Superannuation Fund Professionals' Association of Australia Limited), as well as consumers groups (CHOICE and Consumer Action Law Centre), the Financial Services Ombudsman, the Financial Sector Union and ASIC.

34. It is important to note that views expressed by stakeholders at PCG meetings do not necessary represent the final views of that organisation. These would only be delivered through a formal consultation process.

35. s47C

36. s47C in 2011, an article focusing on the views of ISN provided a review of intra-fund advice to date which found that since the introduction of RG 200 approximately 50,000 super members have taken advantage of the new regime.[5] The review confirmed that very few funds have relied heavily on CO 09/210 when providing intra-fund advice to members. Throughout the article, ISN stresses the importance of RG 200 in facilitating intra-fund advice.

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[5] Hughes D, ISN to provide in-house advice, *Australian Financial Review*, 13 September 2010.

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Regulation impact statement: Replacement of Accountants' Exemption

Problem

1. Advice provided by accountants and financial advisers is an important driver in the establishment and closing of a self managed superannuation fund (SMSF). As a general rule, Australian financial services providers are obliged to be licensed, that is, to obtain an Australian Financial Services Licence (AFSL), under the financial services regime introduced through the Financial Services Reform Act 2001 (FSR Act).

2. However since 2004, recognised accountants (who have membership of at least one of three specific accounting bodies[1]) have been exempt from the requirement to be licensed when providing advice concerning the acquisition or disposal of an interest in an SMSF.

3. There is a perception that accountants face a significant conflict of interest and bias in making recommendations about the establishment of a SMSF. An accountant may gain significant revenue from a client"s decision to start a SMSF through setting up the SMSF and providing professional services to support a SMSF, such as audit and compliance work.

4. Accountants are not permitted to advise on investment strategies for the SMSF, on the relative merits of superannuation compared with other financial products or on any other superannuation product unless they are licensed financial services providers. This means the advice that unlicensed accountants can provide in relation to SMSFs may be lopsided, and skewed towards recommending a SMSF. There are concerns that the exemption creates an uneven playing field and many sections of the financial services industry object to the licensing carve out for accountants.

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[1]Includes the Institute of Chartered Accountants in Australia (ICAA), the National Institute of Accountants (NIA), and CPA Australia.

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The FSR Act is intended to ensure that people receiving advice are fully informed of their options, and that such advice comes from those who are required to be familiar with, and educated upon, the ranges of options within the areas in which they give advice. s47C

6. The professional accounting bodies have also indicated to Government that they consider the current framework to be unsatisfactory as it does not enable accountants to talk to their clients about financial products outside of SMSFs. Accountants are often approached by their clients to provide feedback on a broad range of financial issues particularly in the areas of superannuation, insurance and basic deposit products. This work is often incidental to the mainstream work of accountants (providing advice to clients on taxation and accounting matters).

7. As accountants are generally not aligned to any provider of financial products, accountants have indicated that they are generally not interested in providing advice to clients about specific products (for example, recommending a superannuation fund that the client invest their money with). Rather, accountants are interested in providing advice at the „class of product" level. For example, this advice might cover whether the client should invest surplus cash into a superannuation fund or a term deposit, but would not make recommendation about any specific superannuation fund or term deposit. This form of advice is sometimes referred to as „non-product" advice because it does not involve making specific product recommendations.

8. Currently, most accountants cannot provide this advice to their clients because they do not have an AFSL even though their background and experience may mean they are qualified to obtain a licence. s47C

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Objectives of Government action

10. In April 2010, the Government announced that:

"The exemption permitting accountants to provide advice on the establishment and closing of self-managed superannuation funds (SMSFs) without holding an Australian Financial Services Licence (AFSL) will be removed. The Government is concerned that the current exemption does not provide an appropriate framework for advice in relation to SMSFs and superannuation more generally. The Government will consult with industry on an appropriate alternative to the current exemption, including a potentially a streamlined licensing regime, and there will be an appropriate transitional period."

11. Further in December 2010, the Government responded to a recommendation of the Super System Review that the:

"Government should legislate to require advisers to hold an AFSL where they provide advice in relation to the establishment of an SMSF. The accountants" licence exemption should not be replaced by any new exemption or restricted licensing framework."

12. The Government response stated:

"The Government agrees that the accountants" Australian financial services licence (AFSL) exemption should be removed, and is currently consulting with industry on an appropriate alternative to the exemption as part of the Future of Financial Advice process, including a restricted licensing framework."

13. The objective of Government action in this area is to ensure that there is an appropriate regulatory framework governing the provision of SMSF advice to clients. As noted above, there are concerns that the existing exemption for accountants exclude the operation of the consumer protection elements introduced by FSR and proposed through the *Future of Financial Advice* reforms.

14. As part of this process, it would be desirable if a solution could be reached that allowed accountants the ability to provide a broader range of financial advice to their clients in situations where their experience and qualifications mean they are suitably qualified to provide this advice. This would be consistent with the Government"s objectives around improving access to financial advice (see associated regulation impact statement on access to advice).

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Consultation

1. The issue of the appropriate replacement for the accountants" exemption and the delivery of „non product" forms of advice have been canvassed in some detail at the Future of Financial Advice Peak Consultation Group (PCG) meetings. The PCG is the primary forum through which the Government has consulted with industry on the implementation details of the FOFA reforms. The PCG has met five times since the reforms were announced. At four of those meetings, the issue of non-product advice was discussed.

2. The PCG includes a broad range of stakeholders including industry (Association of Financial Advisers, Financial Planning Association, Financial Services Council, Australian Financial Markets Association, Industry Super Network, Association of Super Funds of Australia, Australian Bankers Association, Law Council of

Australia, the professional accounting bodies, Australasian Compliance Institute, Insurance Council of Australia, National Insurance Brokers Association, Abacus and Self-Managed Superannuation Fund Professionals" Association of Australia Limited), as well as consumers groups (CHOICE and Consumer Action Law Centre), the Financial Services Ombudsman, the Financial Sector Union and ASIC.

3. In addition to PCG meeting, Treasury has met separately with the professional accounting bodies to discuss this issue on numerous occasions.

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Regulation impact statement: ***Carve out for simple products and treatment of soft dollar benefits***

Background

1. This Regulation Impact Statement (RIS) relates to a Government decision to ban conflicted remuneration structures. A RIS *(Ban on conflicted remuneration structures that distort financial advice: Introduction of adviser charging rules)* was prepared in relation to this decision. This RIS deals with two areas relating to the ban on conflicted remuneration structures. While the ban on conflicted remuneration structures has been announced by Government it does not apply until 1 July 2012. This RIS deals with the application of the ban to simple deposit type products and also how soft dollar benefits are to be treated under the ban.

Current approach – conflicts of interest, disclosure, remuneration and provision of personal advice

2. The *Corporations Act 2001* (the Corporations Act) regulates financial products and services in Australia. One way in which an investor acquires a financial product is as a result of following financial product advice. There are relevant conduct rules around the giving of financial product advice and rules to ensure participants behave fairly and honestly. There are also disclosure requirements designed to overcome information asymmetry between industry participants and investors where disclosure assists investors to make informed decisions.

3. Currently, the Corporations Act requires that conflicts of interest be managed and disclosed. The law requires that fees or remuneration (including commissions and other payments) are disclosed clearly to retail investors. It does not set limits on what can be charged or how it can be charged. The Corporations Act also requires that advisers have a reasonable basis for financial product personal advice (advice is considered appropriate if it is fit for its purpose—that is, if it satisfies the client's relevant personal circumstances). Under equitable principles, there are some duties owed by persons providing advice to their clients arising out of the advisor/client relationship. However, there is a lack of clarity around when those duties apply and precisely what is required to comply with them.

4. Under the Corporations Act, generally before the financial service is provided, a retail client must be provided with a Financial Services Guide (FSG) that contains information about remuneration, including commissions or other benefits to be received by an adviser. If personal advice is given, generally the retail client also receives a Statement of Advice (SOA) from an adviser which includes information about the advice and remuneration and commissions that might reasonably influence the adviser in providing advice. Generally, before a product is provided, a retail client must further receive a Product Disclosure Statement which must also include information about the cost of the product and information about commissions or other payments that may impact on returns.

Government decision -future approach to remuneration affected by conflicts of interests and personal advice

5. In April 2010, the Government announced the Future of Financial Advice (FOFA) reforms. Amongst other reforms, the Government announced a prospective ban on conflicted remuneration structures in relation to advice and distribution of retail investment financial products. The ban includes commissions and any form of volume based payment. Restrictions were also placed on the use of asset based fees. This prospective ban applies from 1 July 2012. Reform was also announced such that licensees and its representatives must have due regard to the clients' best interest when providing personal advice.

6. The context of the FOFA reforms reflects the ongoing debate about the sales focus of the financial advice industry and mismatch with consumer expectations about receiving a professional unbiased advice service. There was concern that certain remuneration structures were creating strong conflicts which were not being sufficiently addressed through current regulation that requires conflicts to be managed and disclosed, and that this was adversely impacting on the quality of advice.

7. The issue was considered by the Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into Financial Products and Services into Australia* (PJC Inquiry). The PJC inquiry was set up following collapses of Storm Financial and Opes Prime. In relation to conflicted remuneration structures, the PJC recommended that the Government consult and support industry in developing the most appropriate mechanisms to cease payments from product providers to financial advisers. The PJC also recommended that the Corporations Act be amended to include a fiduciary duty for financial advisers, requiring them to place their clients' interests ahead of their own.

8. The FOFA reforms also form the Government's response to the PJC Inquiry.

9. At the time the Government announced the FOFA reforms, it noted that there would be implementation consultation. One of the issues raised during implementation consultation is how the ban applies to advice and distribution of simple retail banking products. Further, at the time of the announcement, the Government stated that the ban did not initially apply to soft-dollar benefits but that the newly established expert advisory panel, in relation to its review of ethical standards, will consider whether those payments are consistent with those standards. Ultimately, however the Government announced that Treasury will advise the Government as to the best way of extending the ban to soft dollar benefits.

10. The RIS on conflicted remuneration structures provides background to the structure of the financial advice industry including retail investments, fees, industry data and remuneration models.

11. The application of the ban to simple deposit type products and soft dollar benefits are dealt with separately below.

APPLICATION OF BAN AND BEST INTERESTS TEST TO SIMPLE DEPOSIT TYPE PRODUCTS

Problem identification

12. The ban on conflicted remuneration structures relates to the need to address strong conflicts of interest which may adversely affect the quality of advice received by a client. The best interests duty reflects the need to ensure that licensees and their representatives have due regard to their client's best interest when providing personal advice to retail clients.

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14. During implementation consultation, issues have been raised about the application of the ban on volume payments (essentially employee sales incentives), as well as the best interests test, to the

distribution of simple retail banking products, which in the main includes deposit type products.

15. Some banks operate a 'no advice' model relying on the existing 'clerks and cashiers' exemption in subsection 766A(3) of the Corporations Act. In these cases, banks do not provide financial advice but factual information only. However other banks do offer financial advice about basic retail banking products.

16. In relation to volume payments, issues have been raised that the ban will capture payments made to employees for distribution and advice in relation to simpler retail banking products (generally the incentives are based on meeting sales related targets but can include other criteria). This would apply to banks that offer 'no advice' and banks that do provide advice. Concerns relate to the costs of streamlined compliance processes and systems necessary to implement the ban as well as significant changes to employee remuneration and workplace arrangements, where there is not the same level of conflict, risk and potential impact on the advice process.

17. The best interest 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 some basic personal circumstances. In relation to this duty, there is concern about significant compliance costs and impracticalities of the duty relating to personal advice given by an employee of an Authorised Deposit- taking Institution (ADI) in relation to that ADI's own simple deposit products – in many cases, this advice is given by front line teller staff.

18. In practice these employees only provide advice on products offered by the bank, for example deposit products offered by the bank to meet the customer's needs, taking into account limited personal information and providing basic product information, such as current interest rate information. In these circumstances, it would be practically difficult to meet the best interests test, which for example, requires that an adviser consider the person's existing financial products. While the best interests duty does not include a requirement to consider every single product in the market to find the 'best' product, the duty will require more consideration than one product. In the case of front line teller staff providing advice about a basic deposit product, there are concerns that this is not practical for staff to give advice on a competitor's product. There are concerns that the costs of this regulation will outweigh any benefits, given there is not the same level of conflict, risk or impact on the advice process.

Objectives of Government action

19. The objective of Government action is 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.

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Consultation

33. As part of the implementation of the FOFA reforms, the Government is consulting with industry and consumer groups on the implementation of the reforms. The consultation process is being managed through a Treasury peak consultation group (PCG), comprising key industry and consumer stakeholders (as well as ASIC), and through additional targeted consultation.

34. In the mid-2010 and early 2011, senior Treasury officials undertook public information sessions on the FOFA reforms in all Australian mainland state capital cities. As well as providing information to stakeholders, these sessions also provided an opportunity for attendees to provide their views to Government on all FOFA measures.

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SOFT-DOLLAR BENEFITS

Problem identification

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44. Soft dollar benefits are potentially another form of conflict of interest which may distort the advice received by a consumer from an adviser. As noted by the research in ASIC Report 30 *Disclosure of soft dollar benefits* (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. Specifically in relation to soft dollar benefits, ASIC states: 'There is significant evidence (both direct and implicit) that in some instances soft dollar benefits do influence advice and product selection'. 'Indirect evidence also suggests incentive schemes influence individual advisers: firms would not spend millions of dollars on such schemes if they had no effect'.

45. Currently conflicts of interest are not banned under the Corporations Act. A licensee is 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 which may reasonably be expected to be capable of influencing the advice.

46. Given the announced prospective ban on conflicted remuneration structures, which involves commissions and any form of volume payment, it is possible that soft dollar benefits may be used to replace commissions and volume payments and thus continue to influence

product recommendations and strategies. While it is noted that some of the soft dollar benefits (as defined broadly) may be captured by the ban on volume payments and soft dollar benefits vary considerably, from minor gifts valued at $50 to bonuses worth tens of thousands of dollars, there will be some remaining soft-dollar benefits of sufficient weight to create conflicts of interest and influence the advice process.

47. There is a question about whether continuing to allow these soft dollar benefits will undermine the FOFA reforms, by providing an alternative mechanism for product providers or licensees to influence recommendations which impacts on the quality of advice.

48. There is no uniform definition of the term 'soft dollar benefits' or 'alternative forms of remuneration'. The broadest definition is used in ASIC Report 30, which defines 'soft dollar benefits' 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.

49. 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: Free or subsidised business equipment or services, such as computers, software, and industry association membership fees; Hospitality, such as tickets to sporting events; Adviser conferences; A higher share of commissions paid to an adviser; Higher commission rates based on volume; 'Marketing support' payments; Shares (or options) in the product provider or advice licensee; and buyer of last resort agreements. There are also benefits paid by product providers to advice licensees; Cash sponsorship of a licensee's adviser conference; and loans.

50. The report also identified benefits paid by product providers to advice licensees or related platforms which included 'Fee rebates' or profit sharing arrangement.

51. The Financial Services Council (FSC) (formerly IFSA)/FPA Industry Code of Practice on Alternative Forms of Remuneration in the Wealth Management Industry dated July 2004 (FSC/FPA Code), defines 'alternative forms of remuneration' slightly differently, in that it attaches concepts of materiality and influence to the receipt of these benefits. The FSC/FPA Code states that:

52. *Alternative forms of remuneration are certain material benefits (other than the payment of commissions or service fees) provided or made available to a licensee, platform or representative from a third party that*

may influence or be perceived to influence the choice and use of the product or service of the third party (paragraph 3.1).

53. The FSC/FPA Code use a dollar amount threshold of $300 or equivalent per benefit to determine materiality. Under the FSC/FPA Code, a certain ‘material’ transactions must be disclosed on a register which is publicly available upon request, unless the transaction is banned (if based on volume) or exempt (for example professional development that meets certain criteria).

54. Currently, the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia APS 12 Statement of Financial Advisory Service Standards (APS 12) uses $300 worth of benefits from one party in a 12 month period as a benchmark but, in its proposed new standard, this threshold has been removed and only 'trivial or insignificant' soft dollar benefits are permitted.

55. It is worth noting that any volume based 'soft dollar benefits' are banned under the FSC/FPA Code. Further both the current APS 12 and the proposed Accounting Professional & Ethical Standards Board APES 230 (APES 230) ban additional remuneration based on sales volumes unless rebated in full to the client. Under the codes, it is generally accepted that the provision of computer hardware and office rental is not a permissible soft dollar benefit. Alternative remuneration to support financial planner professional development conducted in Australia that is non-volume based appears to be generally accepted as permitted in the industry codes.

56. It should also be noted that while industry codes do set a benchmark, there are issues with enforcements of these industry codes.

Objectives of Government action

57. The objective of Government action is 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.

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Consultation

95. As noted, the announced ban on conflicted remuneration structures did not initially apply to soft-dollar benefits, with the expert advisory panel, in relation to its review of ethical standards, to consider whether these payments are consistent with those standards. The expert advisory panel is constituted by industry association, consumer groups, financial advice groups, the regulator ASIC and Treasury.

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97. More broadly, the PJC undertook an extensive public consultation process in developing its recommendations following its inquiry into financial products and services in Australia. The RIS: (Ban on conflicted remuneration structures that distort financial advice: Introduction of adviser charging rules) sets out the views of stakeholders in relation to conflicted remuneration structures generally. In its report, the PJC noted it received considerable evidence suggesting that the most effective way to improve the quality of financial advice for consumers is to remove conflicts altogether by banning commissions and other conflicted remuneration practices.

98. Some submitters to the PJC inquiry specifically addressed the issue of soft dollar benefits. In its submission to the PJC, ASIC recommended that soft-dollar benefits be banned as another form of conflicted remuneration. CPA Australia also recommended that specific soft dollar benefits from third parties that place the interests of the financial adviser in significant conflict with those of the client be banned. The Accounting Professional and Ethical Standards Board (APESB) also recommended that soft-dollar benefits relating to product sales be banned. The Institute of Chartered Accountants consider it is important that the remuneration models are based on the payment from the client and not from the product manufacturer, and that it is important that the linkage between the product manufacturer and the adviser is removed. The Industry Super Network also supports the banning of other conflicted remuneration structures. Choice also advocates that soft-dollar benefits be banned.

99. Further public consultation on any draft legislation implementing the recommendations is also envisaged prior to introduction of the Bill into Parliament.

s47C pp87-88

Regulation impact statement: Treatment of paid commissions on insurance products within superannuation and life insurance products outside superannuation

Problem

1. Financial advisers or brokers that advise on and sell life insurance to consumers (hereafter „advisers") are traditionally remunerated differently from other occupations. For example, many advisers traditionally receive commissions from life insurance providers for placing clients with particular products. For sales to retail consumers in particular, commissions form an important means of insurers distributing their products and paying for the adviser"s services in facilitating a sale. s47G

While commissions vary in structure, complexity and size, it is not unusual for an insurer to pay an adviser an upfront commission in excess of 100 per cent of the annual premium for selling a policy, with an ongoing trail commission of between 20 and 30 per cent.

2. When the Government announced the *Future of Financial Advice* (FOFA) reforms in April 2010, it outlined a ban on conflicted remuneration, including commissions and volume-based payments, in relation to investment and superannuation products.[2] The basis for the reforms was to eliminate remuneration structures that distort advice. However, it noted that the ban on conflicted

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[2] "Overhaul of Financial Advice", media release issued by the former Minister for Financial Services, Superannuation and Corporate Law, 26 April 2010, available at http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType=0

remuneration would not immediately apply to risk insurance due its features that make it unique from investment products, including the absence of investible funds from which to pay for advice and concerns around levels of underinsurance in the Australian community. Consideration of risk insurance commissions was therefore postponed until 2011.

3. In December 2010, the Government announced its Stronger Super package in response to the recommendations of the Super System Review.[3] As part of this response it agreed that trustees of MySuper products will not be permitted to pay premiums for insured member benefits that include commissions in relation to the group insurance product.[4] In adopting this stance, the Government noted that it would consult on whether the prohibition on commissions should also extend in relation to insurance offered through MySuper other than group insurance and other superannuation products.

4. As a result of the FOFA and Stronger Super announcements, the Government will make a decision on the permissibility of advisers receiving commissions on all classes of life insurance products both within and outside of superannuation (other than group insurance cover offered through MySuper products).

Objectives of Government action

5. The Government"s objective is to ensure that the remuneration structure of life insurance advisers is appropriately aligned with the interests of their clients. Its objective is also to ensure that insurance premiums paid for by superannuation fund members, who may be unaware of the premiums they are paying, do not have their retirement savings unduly reduced by commissions which risk making their cover sub-optimal or unnecessarily expensive.

6. In attempting to minimise conflicts inherent in certain adviser remuneration structures, the Government is conscious of not unnecessarily eliminating a channel for distributing life insurance

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[3] For more information, see the Government"s Stronger Super website, accessible at http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm

[4] See recommendation 5.12 of the Super System Review, and the Government"s response through Stronger Super.

cover which would exacerbate levels of underinsurance in the Australian community.

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Consultation

33. The Government has consulted on the treatment of life insurance commissions since the beginning of 2011. However, it has been receiving submissions from various interested stakeholders since the announcement of the FOFA reforms in April 2010.

34. Treasury developed a peak consultation group to be consulted on a number of aspects of the FOFA reforms, convening meetings in most months since October 2010. On 24 January 2011, a PCG meeting was convened exclusively to discuss the application of the FOFA reforms to insurance, with commissions being the key focus of discussion.

35. Treasury also consulted with the superannuation industry through the Stronger Super consultation process that was established on 1 February 2011. The MySuper working group specifically considered commissions on insurance offered through superannuation at its meeting on 16 March 2011.

36. In addition, Treasury has met with a number of stakeholders on this issue, including representatives of insurers, brokers and advisers.

37. For those stakeholders unable to meet with officials, the Government has been continually receiving and analysing written

submissions to its FOFA email submission facility, which is futureofadvice@treasury.gov.au.

Views on treatment of life insurance commissions

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Regulation impact statement: Renewal requirement for ongoing financial advice fees to retail clients

Problem

1. Australian Financial Services Licensees that provide financial advice to retail clients (hereafter „advisers‟), are traditionally remunerated differently from other occupations. For example, many advisers have traditionally received commissions from product providers for placing clients with particular products, often paid as a percentage of funds under management. Some commissions are ongoing in nature, forming what are known as „trail‟ commissions.

2. In situations where the client pays a substantial proportion of the adviser‟s remuneration directly (known as „fee for service‟) it is common for this 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 (know as asset-based fees) or a flat dollar amount. This annual fee generally covers a range of advisory services provided to (or available to) clients. As opposed to professions or other occupations that tend to charge for transactional, one-off services or advice, 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.

3. As a result of this unique remuneration structure, in some situations clients of advisers that pay ongoing fees for financial advice receive little or no service. Of the clients that do receive a service for the fees they are paying, some are unaware of the precise magnitude of those fees (or the fees advisers are receiving from third parties) or they continue paying ongoing fees as a result of their own disengagement. This is despite the fact that most ongoing advice contracts allow a client to „opt-out‟ at any time.

4. The concept of compulsory renewal of ongoing advice fees, requiring the active renewal by the client to ongoing fees, is

designed to protect disengaged clients from paying ongoing financial advice fees where they are receiving little or no service. For those that are not disengaged, the renewal requirement will nonetheless force the client to consider whether the service they are receiving equates to value for money.

5. Although ongoing fees are disclosed to clients upon engagement of the adviser‟s services (via the Statement of Advice requirement prescribed under the *Corporations Act 2001*), there is no ongoing advice fee disclosure requirement. This initial disclosure requirement alone is not a guaranteed safeguard for clients that become disengaged after a number of years of paying ongoing advice fees.

Objectives of Government action

6. In April 2010, the Government announced the *Future of Financial Advice* (FOFA) reforms.[1] One of the measures included as part of this announcement was the introduction of a compulsory annual renewal requirement for situations where advisers wish to charge ongoing advice fees to retail clients. From 1 July 2012, advisers must seek to renew client agreement to ongoing advice fees annually. The client must „opt-in‟ in response to the compulsory annual renewal notice sent to them by their adviser, or the adviser cannot continue to charge an ongoing advice fee.

7. The objective of the compulsory annual renewal policy is to enable consumers to understand the fees they are paying for ongoing financial advice, so that they can make a decision about whether they are receiving value for money for the fees paid. It is also aimed at ensuring that ongoing advice fees cannot be charged to retail clients that are uncontactable and therefore receiving no financial advice.

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[1] "Overhaul of Financial Advice", media release issued by the former Minister for Financial Services, Superannuation and Corporate Law, 26 April 2010, available at http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&min=ceba&Year=&DocType=0

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Consultation

27. Since the announcement of the FOFA reforms by the Government in April 2010, Treasury has undertaken extensive consultation with a range of stakeholders on the compulsory annual renewal requirement, and the potential alternative two-year opt-in model with annual disclosure.

28. Treasury developed a peak consultation group to be consulted on a number of aspects of the FOFA reforms, with meetings held in October, November and December 2010 and January and March 2011. The opt-in policy was an agenda item and discussed at each of these meetings.

29. In the mid-2010 and early 2011, senior Treasury officials undertook public information sessions on the FOFA reforms in all Australian mainland state capital cities. As well as providing information to stakeholders, these sessions also provided an opportunity for attendees to provide their views to Government on the impact of the opt-in policy and other FOFA measures.

30. In addition, Treasury has undertaken one-on-one consultation with a number of stakeholders on this issue, including banks, product manufacturers, industry groups, consumer groups, and individual advisers.

31. For those stakeholders unable to meet with officials, the Government has been continually receiving and analysing written submissions to its FOFA email submission facility, which is futureofadvice@treasury.gov.au.

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