TREASURY EXECUTIVE MINUTE

Minute No. 20111045

4 April 2011

Assistant Treasurer and Minister for Financial Services and Superannuation

cc: Deputy Prime Minister and Treasurer

EMPLOYEE BONUSES AND FINANCIAL ADVICE

Timing: At your discretion

Recommendation/Issue:

- That you note this briefing on the application of the ban on conflicted remuneration to employee performance pay for advising on financial products.
- That you note the benefits of a potential carve-out of basic deposit products from the ban on employee bonuses and the best interests duty.

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KEY POINTS

- The *Future of Financial Advice* (FOFA) reforms, announced by Minister Bowen in April last year, included a ban on conflicted remuneration, including volume based payments or sales incentives. This will include a ban on payments from licensees to their employee advisers based on volume of client funds under management or volume of financial products sold.
- At the most recent meeting of the FOFA peak consultation group, Treasury sough the input of stakeholders on the issue of institutional employees advising on their own products.
  - 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 and complex products.
  - Frontline sales staff selling their employer's products would be able to continue receiving sales bonuses or 'internal commissions' for basic, low risk products, such as savings accounts and term deposits.
- The proposed carve-out for frontline sales staff would not represent a loophole for financial advisers. It would allow existing arrangements for sales staff (such as bank tellers), where there is no evidence of misselling or consumer detriment, to continue.
- For the same reason, and for simplicity, it is proposed that frontline sales staff advising on their employer's basic deposit products also be carved-out of the best interests duty.

Contact Officer: Ext:

Manager
Financial Services Taskforce Unit

ADDITIONAL INFORMATION

Application of reforms on employee advisers

- The FOFA reforms include a ban on conflicted remuneration, including volume based payments or sales incentives. This includes a ban on payments from licensees to their employee advisers for the distribution of financial products, of which there are two main types:

  – Bonuses based on the volume of client funds under management (and in a financial product); and

  – Bonuses based on the volume or number of products sold to customers. This can include additional bonuses for attaining sales targets, but can also merely represent a flat bonus per product sold.

  s47C that the ban on conflicted remuneration should apply to salaried financial planners that essentially receive 'internal commissions' from their employers in the form of employee performance pay.

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  – In situations where employees hold shares in their employer, there will always be an indirect conflict between an employer's profitability through selling products and the advice that salaried planners provide. However, the profitability of institutions such as banks is not only determined by financial product sales. Also, all shareholders benefit equally from high share returns, not just those that sell more products, making any conflict less acute.

    : We would envisage that anti-avoidance provisions would apply to prevent share scheme arrangements purely designed to get around a volume payments ban in the legislation.

- Salaried advisers would continue to receive bonuses, but where they are giving financial advice, these bonuses would need to be linked to performance indicators other than product sales (for example, client feedback, client retention or fee for service revenue).

  – We note that although asset-based fees on ungeared funds will be permissible under the FOFA reforms as a legitimate form of fee-for-service revenue, this fee arrangement is essentially based on the volume of funds invested in a product.

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Carve-out for front-line sales staff (for basic products)

Conflicted remuneration

- The current preference is for the ban on conflicted remuneration to not apply for frontline sales staff advising on their employer's basic deposit products. This is best done by exempting the ban in relation to financial advice in relation to particular products that tellers most likely to advise on and sell. Doing this would ensure that the routine activities of tellers are not unnecessary caught by the FOFA reforms.

– It is very common in banks and building societies for sales staff such as tellers to receive bonuses for reaching certain sales targets. To ban this activity would result in a fundamental shift in the way these institutions distribute their products.

– In the case of basic deposit products, there does not appear to be a case for banning sales incentives to tellers. These products are easy to understand, and consumers generally understand that tellers (unlike financial advisers) are in the business of selling their employer's products.

  : Most importantly, we have not received any evidence of any consumer detriment of large-scale misselling of these products, nor was it envisaged that FOFA was aimed at addressing standards or conduct in this part of the sector.

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Best interests duty

- To ensure a consistent application of the FOFA reforms to basic deposit products, it would be preferable for such products to be carved out of the best interests duty which is being implemented under FOFA.
  - The best interests duty will require licensees and their authorised representatives to have due regard to their clients' best interests when providing personal advice to retail clients.
- Similar to the exemption for the conflicted remuneration ban, exempting basic deposit products from the best interests duty will ensure that the current business model used by banks for distributing their products is not unnecessarily disrupted by the FOFA reforms. The exemption will ensure that frontline sales staff such as tellers can assist customers on simple banking matters without having to comply with all aspects of the best interests duty (such as, for example, considering the customer's existing products and the merits of competitor products).
- It is likely that if the duty is applied to front line sales staff selling basic deposit products, many financial institutions will move to general or no advice models to avoid the duty. This would deny personal advice to customers regarding these products. Given the low risk nature of the advice being providing, we feel being denied this advice would be a larger detriment to customers than having access to the advice without the protection of the best interest duty.

Scope of the carve-out: Basic deposit products

- The list of basic deposit products to be carved out of these FOFA measures would include all 'Tier 2' products except for insurance.
  - Treasury initially consulted with the FOFA peak consultation group on a potential exemption from conflicted remuneration for sales staff advising on their employer's products where those products are Tier 2 products.
- Tier 2 products include a number of relatively basic products, many of which are often sold directly to banking and credit union customers. They include:
  - Basic deposit products;
  - Non-cash payment products;
  - First home savers accounts deposit accounts;
  - General insurance products, except for personal sickness and accident; and
  - Consumer credit insurance.
- Tier 1 products include all financial products other than Tier 2 products listed above.

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