

TREASURY EXECUTIVE MINUTE

Minute No. 20110146

20 January 2011

Assistant Treasurer and Minister for Financial Services and Superannuation cc: Deputy Prime Minister and Treasurer

FUTURE OF FINANCIAL ADVICE REFORMS: CURRENT THINKING ON REFORM ELEMENTS

Timing: The next round of public information sessions across Australia will take place in late February and early March.

Recommendation: That you:

- Note Treasury's current thinking in relation to opt-in, volume payments, best interests duty and limited advice as well as next steps in the development of the reforms.

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KEY POINTS

- Following discussions with your Office on 22 December 2010, Treasury has prepared the following material in relation to the FOFA reforms.
 - A summary of the issues and next steps at Additional Information.
 - Treasury's current thinking on the key elements of the FOFA reforms at Attachment A.
 - A table of stakeholder views at Attachment B.
 - A timeline for each element of the FOFA reforms at Attachment C.
 - Further information on options for banning conflicted payments between platforms and adviser groups (commonly referred to as 'volume payments') at Attachment D.
 - Feedback on the December Peak Consultation Group (PCG) meeting at Attachment E.
- Treasury is in discussions with your Office to organise a meeting to discuss the issues covered in this executive minute in the week beginning 31 January 2011.
- The next PCG meeting to discuss these reforms is scheduled for 24 January 2011. This meeting will focus on issues around risk insurance.
 - Treasury is in the process of organising the second round of public information sessions across Australia to take place in late February and early March. We will liaise with your Office about what messages we should deliver at these sessions.

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ADDITIONAL INFORMATION

SUMMARY ON KEY FOIA ELEMENTS

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- This element of the package looks at the expansion of intra-fund advice as well as issues associated with the accountants' exemption and improving access to advice.

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- Treasury is continuing discussions with the professional accounting bodies and ASIC in relation to the accountants' exemption and improving access to advice. These discussions focus on identifying ways in which accountants can be brought into the AFSL regime and whether a new category of non-product advice needs to be established to facilitate the provision of cheaper financial advice.

NEXT STEPS

- The next meeting of the PCG is scheduled for 24 January 2011. This meeting will focus on risk insurance aspects of the FOFA reforms.
- Treasury is in discussions with your Office to organise a meeting to discuss the issues covered in this executive minute in the week beginning 31 January 2011.
- In late February and early March, the next round of public information sessions will take place around Australia. These will focus on issues identified during targeted consultation since the last round of information sessions (in June 2010).
- There will be another PCG meeting in early/mid March to discuss the reforms. Treasury is in discussions with the Office of Parliamentary Council about the timing of drafting instructions. However, we expect most of the actual drafting will not take place until April/May.
- In April, Treasury will send you an Executive Minute seeking your approval for elements of the FOFA reforms and also letters to the Treasurer and Prime Minister (and any other relevant Ministers) seeking their approval.

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- A detailed timeline for each element of the FOFA reforms including key milestones is at [Attachment C](#).

TREASURY CURRENT THINKING ON FOFA ELEMENTS: OPT-IN REQUIREMENT

PROPOSED REFORM

As was announced by the Government on 26 April 2010, the *Future of Financial Advice* reforms will include a prospective requirement for retail clients to agree to advice fees and to annually renew (by opting in) to an adviser's continued services.

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VOLUME PAYMENTS

PROPOSED REFORM

As was announced by the Government on 26 April 2010, the Future of Financial Advice reforms will include a prospective ban from 1 July 2012 on conflicted remuneration structures, including commissions and any form of volume-based payment.

Treasury has consulted on the issues associated with including whether all such payments should be captured by the Government's ban on conflicted remuneration payments.

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BEST INTERESTS DUTY

PROPOSED REFORM

As outlined in the FOFA Information Pack released on 26 April 2010, the Government plans to introduce a statutory fiduciary-style duty that will require advisers to act in the best interests of their clients. The duty will also clarify that in no circumstances is it permissible for advisers to place their own interests ahead of their clients' interest. The duty will include a reasonable steps type qualification, so that advisers are not required to base recommendations on an assessment of every product available on the market.

KEY ELEMENTS OF THE DUTY

Based on consultations with stakeholders to date, we are proposing to formulate a best interests duty with the following key elements.

Scope

- The duty would apply when a person is giving personal advice as defined in the Corporations Act to a retail client.
- There would be no scope to contract out or otherwise exclude the application of the duty.

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Liability

- Compliance with the duty would be tested at the level of the individual who provides the advice to the client. Licensees/authorised representatives and the individual who provides the advice will be able to contravene the duty. However, monetary liability for any contraventions of the duty would rest solely with the licensee or authorised representative. Contraventions by the individuation will be used by ASIC to facilitate administrative sanctions (for example, a banning order).
 - This approach would be extended to the other key provisions relating to personal advice (section 945A, 945B and 947D).

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LIMITED ADVICE

PROPOSED REFORM

One of the two key principles of the FOFA reforms is that financial advice should not be put out of reach for those who would benefit from it. The announced reforms include an expansion of the existing intra-fund advice package, as well as a review of whether other measures are needed to clarify whether simple advice can be provided in a compliant manner outside intra-fund advice.

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PROPOSED MODEL

EXPANSION OF ASIC GUIDANCE

Currently, ASIC's regulatory guide - RG 200 - is intended for those who provide financial product advice to super fund members about their existing interest in a fund. It sets out how this advice can be provided under either s945A of the Corporations Act 2001 (the Act) or, alternatively, the relief provided to super fund trustees if they choose to rely on it. Expansion of the guidance is designed to achieve two objectives:

- To facilitate the expansion of intra-fund advice into new superannuation topics (subject to consultation on which topics should be included) as announced. **s47C**
- To clarify that the principles of RG 200, in particular, that certain regulatory requirements are scalable according to the kind of advice being provided, can be applied to the provision of advice outside of the superannuation context. That is, it would be clear that the principles of RG 200 apply for all providers of financial advice.

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Volume Payments – Discussion Paper

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EXECUTIVE SUMMARY

- The Future of Financial Advice (FoFA) ban on volume payments targets conflicted remuneration structures.
 - The former Minister, Chris Bowen, stated on 26 April 2010 that the measure targeted “*payments which have similar conflicts to product provider set remuneration. The form of these payments also does not engender the right behavior*”.
- At issue is whether all volume payments are conflicted in this sense, and whether potential conflict (where it exists) can be effectively managed.

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- In particular, one form of volume payment stands out as being the most contested: Platform payments to Dealer Groups / Licensees. This type of volume payment is a major focus of this discussion paper.

Note on Terminology

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OPTION TWO – THE INDUSTRY COUNTER-PROPOSAL

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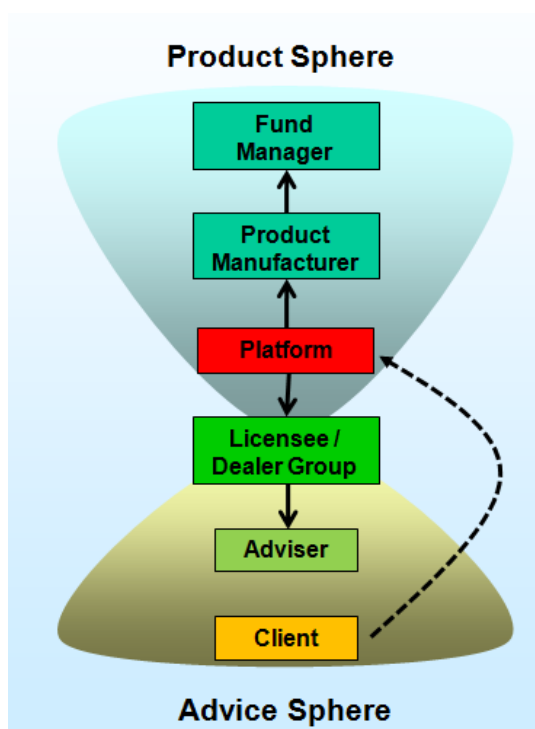
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MORE INFORMATION

BACKGROUND

- The Future of Financial Advice reforms include a prospective ban on conflicted remuneration structures including commissions and volume based payments. The ban on volume based payments covers “any form of payment relating to volume or sales targets (including employee sales and volume targets) from any financial services business, relating to the distribution and provision of advice for retail financial products”.¹
 - As the former Minister, Chris Bowen’s, announcement on 26 April 2010 stated: “This measure is targeted at removing other volume-related payments which have similar conflicts to product provider set remuneration. The form of these payments also does not engender the right behavior”.
- Volume based payments are payments from one entity to another in the “Value Chain (Figure 1).

Figure 1. The “Value Chain” (Treasury Model)



Volume Payments – Discussion Paper

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UNDERSTANDING VOLUME PAYMENTS

- The issues surrounding volume based payments are complex and contested. The first step in addressing the issues is to understand what volume payments are and the many different forms that they can take. This section looks in detail at all forms of volume based payments.

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Volume Payments from Fund Managers to Platforms

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- Thus, for example, the FSA Discussion Papers 10/2 (March 2010) and 10/29 (November 2010) stated the following:
 - “We want to end the practice of product providers levying higher charges and then rebating a portion of them to the consumer, as this sort of „rebate” could obscure the existence of the adviser charge that the consumer could pay”.
 - “[W]e have decided to consult on additional rules to make clear that product providers must not defer, discount or rebate their product charges in such a way that these charges could appear to offset any adviser charges that are payable”.
 - “We felt there was potential for confusion around the distinction between product charges and adviser charges and we did not want the consumer to feel that advice was free or funded by products that paid a rebate”.
 - “Allowing such payments to continue could also lead to the potential for product bias to continue to exist, with those products paying a higher rebate recommended ahead of those products paying a smaller, or no, rebate to help fund the advice fee”.

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THE INDUSTRY COUNTER-VIEW

- As set out in former Minister, Chris Bowen's, announcement on 26 April 2010, the ban on volume payments is targeted at removing all volume-related payments "*which have similar conflicts to product provider set remuneration*".
 - The objective is to ban payments that "*do not engender the right behavior*".

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ⁱ Chris Bowen, Minister for Financial Services, Superannuation and Corporate Law, 9 June 2009 - 14 September 2010, Media Release of 26/04/2010 NO.036, Overhaul of Financial Advice.
<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/036.htm&pageID=003&m=ceba&Year=&DocType=0>

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