

Exposure Draft Corporations Amendment (Future of Financial Advice) Bill 2011 and Explanatory Memorandum

24 | 10 | 2011

ANZ Submission to Treasury

1. Background

ANZ provides wealth products and services through its business unit, ANZ Wealth, which encompasses a number of businesses including ANZ Private, OnePath, E*TRADE, ANZ Trustees, ANZ Investment Lending, Lenders Mortgage Insurance and Super Concepts.

These businesses provide a wide range of financial services and products including funds management, insurance, superannuation, online stock broking, trustee services, investment lending, self managed super fund administration and general wealth management.

ANZ also owns (wholly or partially) a number of financial advice groups. Each advice group is a separate business and has its own Australian Financial Services Licence (AFSL). Collectively, they represent over 10 percent (over 1,800) of Australia's financial advisers and include:

- ANZ Financial Planning (operating under the ANZ Banking Group AFSL);
- Financial Services Partners;
- Millennium3;
- RI Advice, and
- Sentry (37.5 percent owned by ANZ Wealth).

2. Executive Summary

ANZ welcomes the opportunity to comment on the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (referred to in this submission as tranche two legislation) and its associated explanatory memorandum (EM).

ANZ's comments on the draft legislation and EM are predominately limited to the policy objectives and outcomes of the draft bill and EM. In relation to more specific commentary on technical drafting issues, we support the Financial Services Council (FSC) and Australian Bankers' Association (ABA) submissions that address these matters.

ANZ is a strong proponent of financial advice and believes that every opportunity should be made to increase the accessibility and affordability of financial advice to the community while ensuring appropriate consumer protection. We support a strong financial advice industry but also recognise that there will be some in the community who are unable to avail themselves of advice from financial planners. We support the Government's efforts to ensure the financial needs of this part of the community are also met.

In the main ANZ supports the Government's underlying objective of the Future of Financial Advice (FoFA) reforms to improve the quality of financial advice while building trust and confidence in the financial planning industry. We also support the focus on facilitating access to financial advice.

Notwithstanding our support for this objective, we are concerned the tranche two legislation and EM as currently drafted:

- Will unduly inhibit the distribution of a significant number of financial products by banks including products directed at assisting small business and simple and low cost superannuation and investment products;

- Does not include general advice as a carve-out from the ban on conflicted remuneration particularly in situations where the advice meets the conditions of being provided for free and, in relation to superannuation and investments, there is no commission charged on the product;
- Will ultimately lead to confusion and complexity in respect of bank remuneration schemes. Any prohibition on incentives provided for basic banking product sales where those sales are also made in conjunction with advice being given on other financial products will introduce complexity to the bank remuneration environment. This in turn will lead to confusion as to whether an ADI employee is eligible for an incentive sales bonus related to a basic banking product under a variety of different scenarios;
- Is not clear as to how Consumer Credit Insurance should be treated in terms of the ban on conflicted remuneration. We believe it should be treated, for the purposes of the draft bill, as a general insurance product;
- Is not entirely clear as to whether the Execution-Only (non-advice) services carve out from the ban on conflicted remuneration also applies to the stockbroking environment. Further discussions are required between industry and Government to settle the precise nature of the carve-out for stockbroking from the ban on conflicted remuneration;
- Does not reflect the start date for the ban on life insurance commissions in group life policies of 1 July 2013 as announced by the Minister in his media release of 29 August 2011;
- Is silent on the grandfathering of commission and volume bonus arrangements. We believe that all contracts in place before 1 July 2012 should be grandfathered;
- Will require significant procedural and systems changes making compliance deadlines difficult to achieve. This is the most significant challenge faced by the industry.

FoFA implementation changes are significantly amplified when taking into consideration the Government's reform programme in total including its proposed re-shaping of the superannuation system including the implementation of MySuper, SuperStream and the adoption of the new short form PDS regime. There is also a steady flow of regulator reviews impacting various parts of the industry. We expect the cost of implementing these additional reform proposals to be comparable to the cost and resource effort involved in implementing the FoFA reforms.

The sum total of the Government's regulatory reform program outstrips the implementation challenge presented to the industry with Financial Services Reform Act (FSR). With FSR industry was provided with a two year transition period so that it could adjust to the new regime in an orderly manner.

ANZ believes that a transition period of not less than one year from 1 July 2012 should be provided for as part of the Future of Financial Advice package of measures in order to minimise operational risks associated with the implementation of the reforms and ensure that customers are not unduly impacted. In relation to any conflicted remuneration arrangements as they might apply to banks, we request a commencement date of 1 October 2013 so that new arrangements apply on a full bank financial year basis.

3. The application of the best interest duty and the ban on conflicted remuneration to certain wealth and banking products

The Government's Future of Financial Advice package proposes a limited carve-out from the ban on volume payments and the best interest 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.

In addition, in relation to monetary benefits, the ban on conflicted remuneration does not apply to:

- General insurance;
- Life insurance that is not bundled with a superannuation product;
- Individual life policies which are not connected with a default superannuation fund; and
- Execution-only (non-advice) services.

4. Banks and the community

The community has developed a significant level of trust in the services they receive in their local bank branch. Banks provide a convenient service in many diverse and remote regional areas. Many people go to their bank for trusted advice on a wide range of banking, wealth and protection needs and especially for financial advice.

One of our main concerns with the second tranche FoFA legislation is that it will impact customer accessibility to these products and services from their local bank branch.

We believe it is the best interests of our customers to have a seamless experience with ANZ. This ensures that we promote customer engagement with their financial affairs by making them more informed and educated, which in turn gives customers confidence and comfort that they get the right outcome from their banking experience.

5. Australian Prudential Regulation Authority (APRA) Regulation of ADI Remuneration Policies

The remuneration policies of ADIs, which are underpinned by APRA's Prudential Standard APS510, Governance, Prudential Standard GPS 510, Governance and Prudential Standard LPS 510 Governance and its Prudential Practice Guide PPG511, are deliberately framed to ensure the avoidance of inappropriate risk.

The distribution of financial products by ADIs is generally limited to:

- Employees who do not provide personal advice (that is, they can only provide general advice or factual information) unless they are bank-based financial advisers or specialists that are licensed and appropriately authorised to also provide personal advice;
- Employees who have received specific product accreditation training on these products that they are accredited by their employer to sell;
- Employees or contractors (e.g. telesales bureaus) who are only permitted to distribute products issued by their employer ADI (or related body corporate).

As an ADI and an AFSL holder, ANZ complies with APRA's and ASIC's requirements to ensure we have appropriate policies in place to manage conflicts of interest and to ensure that our representatives are adequately trained, competent, supervised and monitored. There are strong inter-dependencies between ANZ's risk management framework and remuneration practices.

ANZ believes that risks associated with the distribution of financial products by banks are best managed under the existing risk management frameworks that have been developed as a consequence of APRA guidance and standards and in order to meet licensing requirements under the AFSL regime.

Further we support the FSC's submission that the definition of conflicted remuneration should not extend to general advice that is available to the public at large since this form of advice is far less likely to influence the decision of a retail client compared with personal advice that is provided with the benefit of a full customer fact find.

Recommendation A: ANZ recommends that the second tranche draft legislation be amended to classify certain benefits given by an employer to an employee or contractor relating to the recommendation of any financial product as not being conflicted remuneration if the ADI can demonstrate that its risk and remuneration policies respond to the relevant APRA standards and guidance on remuneration.

6. Employee performance metrics are set against several indicators

While individual banks' remuneration policies for frontline staff will vary, they are generally based on a balanced approach designed to assess an individual's performance based on a set of indicators, which may depend on the particular role in question.

Remuneration arrangements for frontline banking staff rewards out-performance while ensuring avoidance of inappropriate risk. This is done by utilising a balanced framework, aligned to role specialisation and capability, customer satisfaction and advocacy and a strong compliance management framework that includes risk gateways and where necessary reduction of or ineligibility for incentives for inappropriate behaviour. Even if an employee out-performs in relation to their financial metric, they can still fall short of receiving an incentive payment if they have not met their other non financial performance objectives.

ANZ believes that, viewed in conjunction with APRA regulation of bank remuneration which does not apply to other industry sectors, the balanced score approach to incentivising staff provides appropriate safeguards against the mis-selling of products by bank employees.

Recommendation B: ANZ recommends that where banks utilize a balanced scored approach to incentivising staff that this should not be deemed conflicted remuneration. Consequently we recommend that example 1.2 of the tranche two EM is deleted.

7. Establishing a general advice carve out from the ban on conflicted remuneration

The legislation includes a carve-out from the ban on conflicted remuneration for product sales that occur on an execution-only (non-advice) basis.

ANZ is a strong proponent of financial advice and believes that we should maximise every opportunity to provide low or no cost financial advice to consumers to assist them in making choices about their financial affairs.

General advice can be a very important tool in helping customers to understand financial products or trigger them to consider a more detailed examination through personal financial advice. In this regard general advice can be an important gateway to customers taking greater control of their financial future.

Recommendation C: ANZ recommends that incentive payments related to the provision of general advice on financial products should not be considered as conflicted remuneration under the second tranche legislation if the advice is applied under the following conditions:

- The general advice is provided free of charge; and
- In circumstances where the general advice relates to a superannuation or investment product, no commissions are attached to the product.

ANZ believes the conditions as outlined in recommendations A, B and C will ensure that customers are not placed into products for which they may not be suitable primarily based on inappropriate incentivisation of advisers or bank employees.

8. Issues with the application of the best interest duty and the ban on conflicted remuneration to certain wealth, protection and banking products

The FoFA Information Pack dated 28 April 2011 recognises that certain basic banking products will be carved-out from the ban on conflicted remuneration (section 2.8). The rationale for the basic banking products carve-out is noted as:

- Compliance burden of the new requirements;
- Significant changes to employee remuneration and workplace arrangements;
- Applying where there is not the same level of conflict and risk and in respect of products that have not been implicated in causing severe consumer detriment as a result of inappropriate selling, ie products that are easier for consumers to understand;
- Applying to frontline staff (e.g. tellers and specialists) of ADIs advising on products of the ADI. In this situation consumers will more readily understand that the frontline employee of the ADI is in the business of selling the employer's product.

The carve out recognises that banks play an important role as a one stop shop for the community's banking, wealth and protection needs.

ANZ believes that the limited nature of the basic banking carve-out will introduce new complexity to remuneration arrangements and presents the following implementation issues:

- Reconfiguring our Management Information System to accommodate new remuneration scheme/s will take approximately 12 months at an estimated cost of \$4 million. A start of 1 July 2012 will be unachievable;

Further, a change to bank remuneration arrangements mid bank financial year (which ends 30 September annually for ANZ) would also be confusing to staff and would raise concerns about procedural fairness in the event that remuneration goal posts are to be moved mid year. We deal with this matter in further detail under the heading of transition (below);

- Section 963C (b) (iii) of the draft bill prohibits the incentivisation of staff for recommending basic banking products in circumstances where they are also giving other financial product advice that does not relate to a basic banking product. From a compliance perspective this introduces significant complexity and will be extremely difficult to monitor and track.

Even if a technical solution can be found, the practical application of this provision remains problematic, as outlined by the following example. If a bank employee is in the process of opening a transaction account for a customer who then indicated interest in obtaining salary continuance insurance, the bank employee may need to refer the customer to a different member of staff to deal with the insurance matter,. This would be required in order to preserve the “non conflicted remuneration” treatment of the basic banking product transaction.

This would affect the customer experience - currently a single bank employee could manage a customer’s needs if they traverse a number of areas, whereas under the draft bill the customer’s needs would need to be addressed by two or more people.

9. Carve-out required for other financial products deemed to be lower risk

We also note that in the recent draft Explanatory Memorandum for the Corporations Amendment (Future of Financial Advice) Bill 2011, it states that:

“1.36 Basic banking products are: a basic deposit product or non cash payment facility relating to a basic deposit product, a first home saver account, a travellers’ cheque facility and other products prescribed by regulation.

This provides flexibility to add additional products in the future if it is considered appropriate for them to fall within this arrangement given the constant rate of development in the financial product market.”

We consider that a carve-out to other financial products that may be deemed to be lower risk would also be appropriate. Providing access to these products through bank branches will increase consumer access to simple wealth products and diversification – the most basic wealth protection strategy. If this is not the case consumers who cannot afford personal financial advice may not be able to access these products.

An example of such a product would be a simple superannuation product as defined in the Government’s draft Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011. There are already products on the market that would be deemed to have comparable features to the MySuper product outlined in the core provisions bill.

In the absence of Government embracing carve-outs from the ban on conflicted remuneration based on the recommendations above, we would suggest that the second tranche' legislation or regulations move to accommodate a greater carve-out of simple wealth and protection products.

This, however, is not our favoured course of action due to complexity that could arise from having to amend the legislation or regulations to accommodate numerous products that exist across the banking industry.

Recommendation D: If Government does not accept recommendations A, B or C (above), ANZ recommends that Government work with banks to identify financial products or classes of financial products that would be suitable in terms of their risk to customers to be carved out from the ban on conflicted remuneration. For example MySuper products, and other superannuation products that are comparable to MySuper products that exist prior to the MySuper start date of 1 July 2013, should be carved out from the ban on conflicted remuneration.

10. Clarification of the carve out from the ban on conflicted remuneration as it applies to Consumer Credit Insurance (CCI) Products

As noted above, the Government has provided a carve-out from the ban on conflicted remuneration for general insurance, life insurance that is not bundled with a superannuation product and individual life policies which are not connected with a default superannuation fund.

CCI is a combination of life and general insurance under one insurance contract. Accordingly, it is ordinarily jointly issued by a life company and a general insurer. It is not clear how CCI insurance fits in with the proposed exemptions. For example, under the current provision dealing with non-monetary benefits, CCI could be caught given that life insurance is not exempt.

Further clarity is required on whether CCI is to be treated as a general insurance product or life insurance product. Our preference would be that it be treated as a general insurance product.

Recommendation E: For the purposes of interpreting the carve outs from conflicted remuneration as they apply to general and life insurance products, ANZ recommends that CCI insurance be defined as being a general insurance product

11. Clarification of the carve out from the ban on conflicted remuneration as it applies to stockbroking

ANZ welcomes the proposed carve out for execution-only (non-advice) services from the ban on conflicted remuneration with respect to both monetary and non-monetary (soft dollar) benefits. This is sensible because execution-only services exist to help satisfy customer driven needs and occurs in the absence of the provision of any financial or investment advice.

We also note that the EM refers to a carve-out that will be provided to exclude certain stockbroking activities from being considered conflicted remuneration, with "the precise breadth of the carve-out [being] subject to further consultation".

In particular "the receipt of stamping fees from companies for capital-raising on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market" is mentioned.

Recommendation F: For absolute clarity on the scale of the carve-out from conflicted remuneration as it applies to stockbroking ANZ recommends that:

- The EM and draft bill make clear that the carve out for execution-only (non-advice) services applies equally to stockbroking activities (whether direct to customers or intermediated); and
- Treasury develop with industry a comprehensive list of what specific stockbroking activities are considered capital-raising and are thus exempted.

E*TRADE also has white labelling arrangements in place with a range of businesses to provide services that leverage E*TRADE's platform. E*TRADE has two existing service offerings in relation to white labelling. The first one is the provision of white label services to other financial institutions and the second one with intermediaries that are licensed AFSL holders, both for the provision of 'execution only' stockbroking services. All white label arrangements are governed by commercially negotiated contracts with the white label provider and are purely a transactional service.

Recommendation G: ANZ supports the ABA's submission that prohibiting business-to-business payments that relate to the distribution of products and/or services via white labelling arrangements is unnecessary as it is not inherently creating the circumstance of 'biased advice' and will create unintended consequences such as services being withdrawn resulting in certain products and services being less accessible to retail customers.

12. Ensuring advisers that provide individualised advice on life insurance are appropriately remunerated

ANZ supports the FSC submission with respect to limiting the ban on life insurance commissions in super to default fund arrangements.

The current ban captures all group life policies. This does not take into consideration that the use of a group insurance policy simply reflects the structural arrangement for the delivery of insurance to members of a superannuation fund. It is not an indicator of whether or not a member has received individualised advice and elected to make choices about their insurance cover.

This would appear to run counter to the policy intent of the Minister who indicated at the FSC's Annual Conference on 4 August 2011 that he was more persuaded by the argument against the proposed commissions ban in certain cases such as where there has been work by an adviser that had gone into acquiring the product on behalf of an individual.

ANZ believes the FSC's proposed remedy on this issue is more in line with a policy intent that would seek to have advisers appropriately remunerated for work they undertake in advising an individual on their life insurance needs.

Recommendation H: ANZ recommends the FSC suggestion, that sections 963A(b)(i) and 963A(2) should be deleted and therefore carved-out from the concept of conflicted remuneration, be adopted.

13. Implementation and Transitional Arrangements

13.1 Start date for the ban on commissions on insurance in group life insurance in super

In his media releases of 20 April and 29 August this year the Minister committed the Government to a start date of 1 July 2013 for any ban affecting life insurance commissions. However, as currently drafted the ban on certain life insurance commissions will commence on 1 July 2012. We expect this has been an unintended consequence from the drafting of the second tranche legislation.

Recommendation I: ANZ recommends that the start date for any ban on certain life insurance commissions should be 1 July 2013 as originally announced by the Minister. A start date of 1 July 2013 will give industry an appropriate lead time to enable it to comply with the proposed ban.

13.2 Grandfathering

The FoFA bills and related regulations will result in significant changes to existing advice businesses and, as a result, the reform package could impact on the ability of advisers to provide service, and advice to their clients.

A method by which disruption to advisers could be reduced would be to grandfather all contracts in force immediately prior to the commencement date for the FoFA reforms. Currently neither tranche of the FoFA reforms contemplates grandfathering.

Recommendation J: In light of the significant disruption that the FoFA reforms will create for existing advice businesses, ANZ recommends the grandfathering of all (non workplace related) contractual arrangements in place prior to the commencement date for the FoFA reforms.

With respect to grandfathering of employer super contracts we have argued (below) that the contract ought to be identified as being at the plan level. This will ensure member equity concerns are met at the plan level.

13.3 Specific Transition Arrangements

The main challenge in implementing the Future of Financial Advice reforms is the significant procedural and systems changes required to give effect to the reforms. This is complicated by the uncertainty around the final shape of the FoFA legislation and related regulations. Based on current timelines, the best case scenario is that the FoFA reform package is passed by Parliament by December 2011 with further regulations being made in early 2012.

If the current deadline of 1 July 2012 for the commencement of a significant portion of the reform package remains, this will leave industry with less than 6 months to fully comply with the new regime. Planning for systems changes at ANZ is currently proceeding on a 'best guess' basis and on assumed final legislative outcomes. Our industry has evolved over the last 20 years and many fund managers still have substantial legacy systems and products that they need to manage while there are other current products that will fall into the legacy category as a result of the reforms. The reform implementation timeframe needs to be mindful that industry funds management systems often run on older mainframes that need careful re-programming so as to not undermine the stability and confidence of the super system.

As such, to re-wire all of our systems within a 6 month timeframe will be very difficult to achieve.

We believe the FoFA package will pose an implementation challenge as significant as FSR.

When combined with the Government's broader regulatory reform programme including the reshaping of the superannuation system through the proposed introduction of MySuper, the SuperStream proposals which are intended to move the superannuation industry to a full ecommerce environment, new governance standards and other changes sponsored by regulators, the implementation challenges are even greater. A transition period of two years was provided for the implementation of FSR.

ANZ has made an assessment on the technology impact of the draft FoFA legislation and would be keen to meet with Treasury to discuss these impacts in detail.

In view of the significant scale of the reform programme and the attendant operational risks involved in delivering information technology changes of this magnitude, ANZ believes the Government needs to significantly increase transitional arrangements so that industry can achieve orderly compliance with the new regime.

A 12 month lead time is required to implement material changes to Management Information Systems that would be required to accommodate a new bank remuneration scheme.

On this basis, so as to not introduce a new remuneration scheme to the bank mid bank financial year, we would request that any new conflicted remuneration arrangements as they might apply to banks not commence until 1 October 2013.

Recommendation K: ANZ recommends that a transition period of not less than one year from 1 July 2012 should be provided for as part of the Future of Financial Advice package of measures in order to minimise operational risks associated with the implementation of the reforms. In relation to any conflicted remuneration arrangements as they might apply to banks, we request a commencement date of 1 October 2013 so that new arrangements apply on a full bank financial year basis.

13.4 Aligning MySuper and FoFA

Both the FoFA and MySuper reforms will require significant cost and resources to implement the changes to our default superannuation products.

ANZ considers that where the reforms have a common policy objective, such as with the removal of commission based remuneration for financial advisers, it makes sense for both reforms' commencement dates and transition to be harmonised.

Currently, the effective deadline for the FoFA reforms is 1 July 2012, and the commencement date for new contributions into a MySuper compliant product is 1 October 2013.

Assuming the ban on commission based remuneration for financial advice does become law under both FoFA and MySuper, their respective start dates and potential grandfathering arrangements will trigger a range of complexities that will be very costly to manage.

The FoFA/MySuper date mismatch, with the attendant complexity and cost, will introduce three regimes – pre, interim and post FoFA/MySuper that will undo the confidence in the FOFA and MySuper reforms by exposing this complexity at the individual member level.

The impacts of FOFA and MySuper on ANZ's default superannuation products is shown in diagrams A and B (respectively) at attachment 1.

To help industry manage these complexities, ANZ believes that the FoFA legislation could allow for grandfathering arrangements to take place at a plan level. This will remove complexities at an employer plan level when implementing MySuper.

There will still be some complexities at the account balance and contributions level (as illustrated in the Diagram C), but these are more manageable. The advantage of this proposal is that it allows FoFA to grandfather arrangements that may be more consistent with the underlying contracts with advisers.

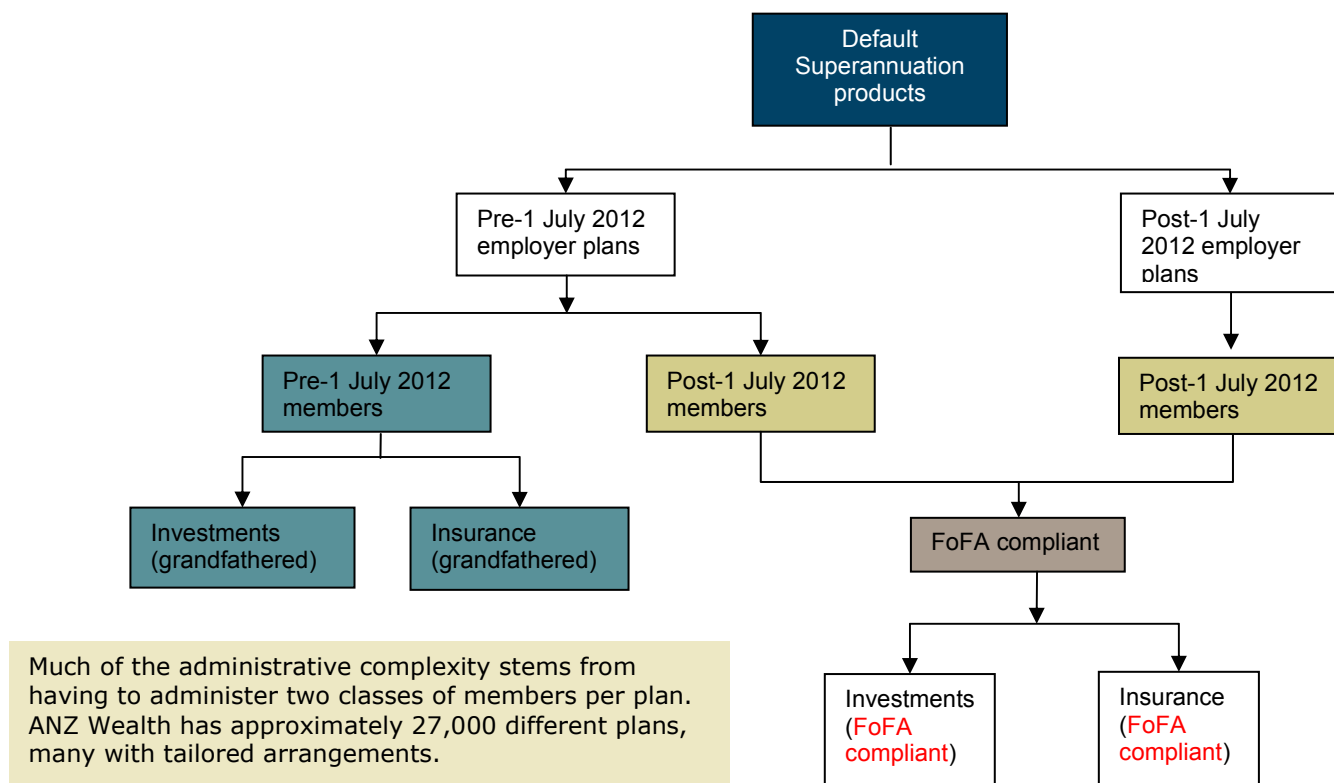
Recommendation L: ANZ recommends Government align the FoFA and MySuper effective start date arrangements to reduce complexities and risks associated with implementing the current reform programme. A suggestion on how this could be achieved can be found at Diagram C in Appendix 1.

Unless some harmonisation takes place between FoFA and MySuper, ANZ believes the cost of implementing both FoFA and MySuper for employer super members will be magnified.

We look forward to the opportunity to present to Government on the difficulties faced by providers and on the other issues raised in this submission.

ATTACHMENT 1

Diagram A
FoFA Exposure Draft scenario -- Impact of Future of Financial Advice on default super funds



As at 1 July 2012:

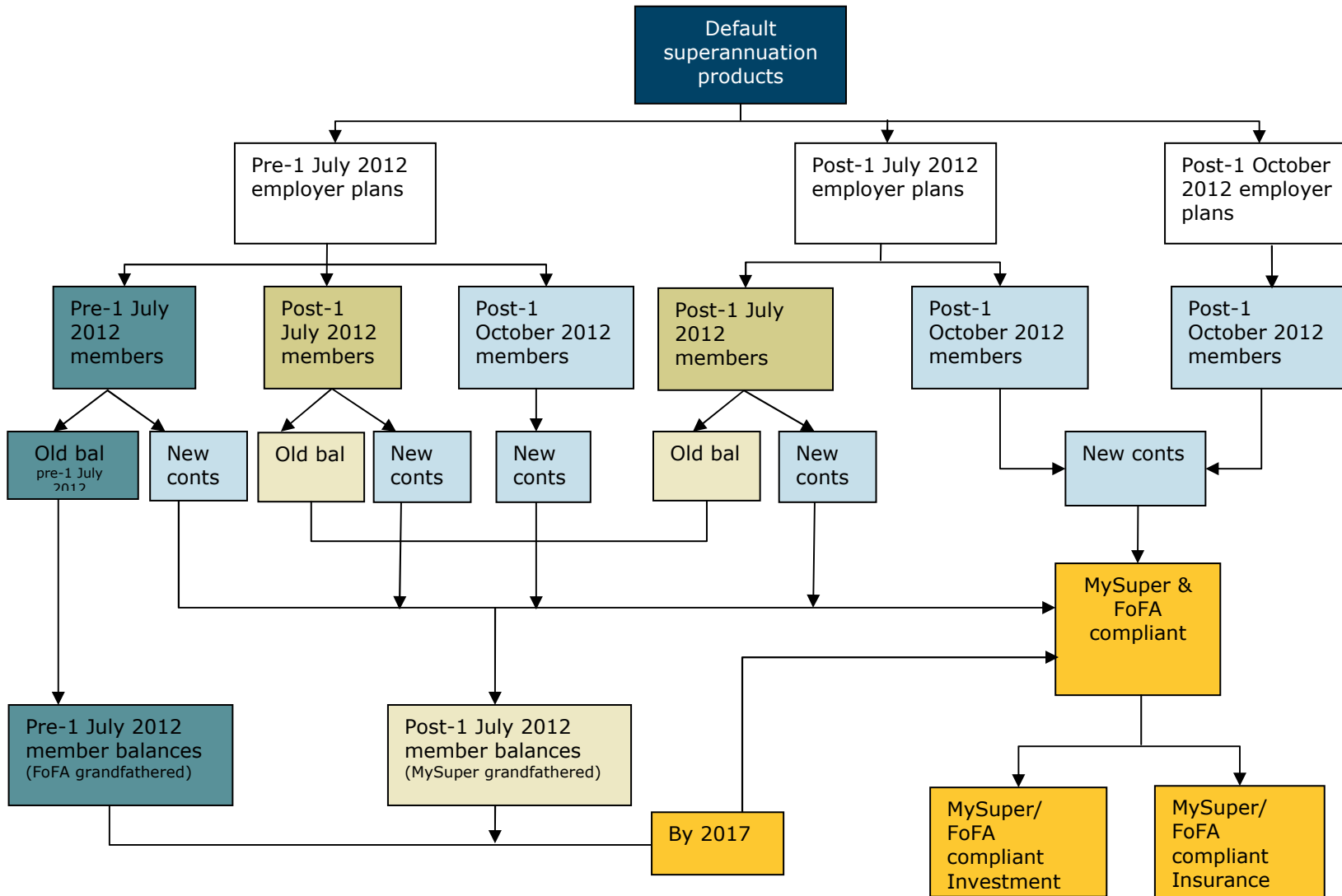
ANZ Wealth has five default superannuation products that will need to become FoFA compliant.

From 1 July 2012, ANZ Wealth's default superannuation products will have employer plans that are either:
 * pre-1 July 2012 employer plans; or
 * post-1 July 2012 employer plans.

Assuming pre-FoFA members may be grandfathered, we will end up with two classes of members for each pre-1 July 2012 employer plan.

All post-1 July 2012 plans should be FoFA compliant as all new members in those plans will also be post-1 July 2012 members.

Diagram B
MySuper Exposure Draft Core Provisions Scenario -- impact of MySuper on default super funds



As at 1 October 2013:

* There is likely to be three types of employer plans at the MySuper start date due to added complexity resulting from FoFA overlay.

* FoFA grandfathering likely to apply at "member" level. This could lead to three different classes of members. In FoFA's current form, members would end up being administered under different plans with potentially different tailored arrangements.

* MySuper grandfathering likely to apply at the "contributions" level. This would allow grandfathering of old balances until 2017, we could end up with pre-FoFA and post-FoFA balances treated differently. We could also have post-MySuper contributions being treated differently.

* ANZ Wealth has five default super offerings sitting under different registry systems. The complexities are likely to be multiplied several times.

As at 1 July 2017:

By this time, all default super balances and contributions will have to be in a MySuper compliant product.

Diagram C
Proposed solution: FoFA grandfathering at "plan" level for default super

Proposal:

* As at 1 July 2012, grandfathering for FoFA will apply to personal super at the member level. However, grandfathering for default super products will apply at the "plan" level. This makes sense because contracts with advisers are typically made at the plan level for default super products.

* This means that new members within a plan will be subject to pre-determined remuneration arrangements under a plan until the plan has to convert into MySuper by 2017.

* All members of the grandfathered plan will be transferred into a MySuper compliant environment together.

