EXPLANATORY STATEMENT

Select Legislative Instrument No. 102, 2014

Issued by authority of the Treasurer

Corporations Act 2001

Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014

Subsection 1364(1) of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed, for carrying out or giving effect to the Act.

The *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* (the Regulation) makes a number of amendments to the *Corporations Regulations 2001* (the Principal Regulations). The amendments relate to Part 7.7A of the Act: the Future of Financial Advice (FOFA) provisions.

As part of its 2013 election campaign, the Government committed to reduce compliance costs for small businesses, financial advisers, and the broader financial services industry, whilst maintaining the quality of advice for consumers who access financial advice.

The Regulation makes the following changes:

- broadening the circumstances when the grandfathering arrangements for the ban on conflicted remuneration apply;
- clarifying that benefits can be paid under a balanced scorecard arrangement;
- clarifying that bonuses paid in relation to ‘permissible revenue’ are not conflicted remuneration;
- clarifying the application of the stamping fee provision to capital raising activities and broadening its application to include investment entities;
- amending the application of the existing brokerage fee provisions to include brokerage fees paid in relation to financial products traded on the ASX24;
- ensuring that the wholesale and retail client distinction that currently applies in other parts of the Act also applies in respect of the FOFA provisions; and
- clarifying the operation of the ‘mixed benefits’ provisions.

Details of these changes in the Regulation are set out in Attachment A.

The Government has also announced that time sensitive FOFA amendments will be dealt with through regulations and then put into legislation. This approach provides

certainty to industry and allows industry to benefit from the cost savings of the changes as soon as possible.

To the extent possible under the primary legislation, the Regulation makes these interim changes until the Corporations Amendment (Streamlining of Future of Advice) Bill 2014 passes the Australian Parliament and receives Royal Assent.

The Regulation makes the following changes:

- removing the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement); this change will apply from the time the Regulation commences until 31 December 2015;

- removing the requirement to provide an annual fee disclosure statement to clients in ongoing fee arrangements prior to 1 July 2013; this change will apply from the time the Regulation commences until 31 December 2015;

- removing the 'catch-all' provision from the list of steps an advice provider may take to satisfy the best interests obligation, and facilitating scaled advice; this change will apply from the time the Regulation commences until 31 December 2015;

- clarifying the treatment of ‘intra-fund advice’; and

- amending the application of the ban on conflicted remuneration including:

  - providing that benefits relating to general advice are not conflicted, subject to certain conditions;

  - amending the execution-only services provision;

  - clarifying the application of the existing client-pays provision;

  - broadening the training and education provision; and

  - broadening the basic banking products provision.

The interim changes will be repealed (to the extent appropriate) following the commencement of the Corporations Amendment (Streamlining of Future of Advice) Bill 2014.

Details of the interim changes in the Regulation are set out in Attachment B.

A draft of the Regulation was published on the Future of Financial Advice website on 29 January 2014 for a three-week consultation period. A total of 57 formal submissions (including 8 confidential submissions) were received from a wide range of stakeholders in the financial services sector, including the Australian Bankers’ Association, the Association of Financial Advisers, Australian Financial Markets Association, Choice, the Financial Planners’ Association, the Financial Services Council, Industry Super Australia and the Law Council of Australia. Further targeted consultation was undertaken following the referral of the Corporations

Amendment (Streamlining Future of Financial Advice) Bill 2014 to the Senate Economics Committee.

The Senate Economics Committee released its report on 16 June 2014. The Regulation is consistent with the recommendations from that report.

Financial advisers and industry associations were broadly supportive of the draft Regulation with consumer groups opposing the changes. A wide range of views were canvassed ranging from requests to make technical changes, to broadening the scope of the changes, to not making any changes. The Government considered these views in preparing this Regulation. For example, some submissions raised concern that the proposal to provide that all benefits relating to general advice are not conflicted remuneration was too broad and would produce adverse outcomes for consumers. In response, the Government decided to limit this exemption to specific circumstances.

A Regulation Impact Statement is at Attachment C.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The *Corporations Act 2001* does not specify any conditions that need to be satisfied before the power to make the Regulation may be exercised.

A Statement of Compatibility with Human Rights is at Attachment D.

This Regulation commences on 1 July 2014.

Attachment A

Details of the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014*

Section 1 – Name of Regulation

This section provides that the name of the Regulation is the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* (the Regulation).

Section 2 – Commencement

This Regulation commences on 1 July 2014.

Section 3 – Authority

This Regulation is made under the *Corporations Act 2001* (the Act).

Section 4 – Schedule(s)

This section provides that Schedule 1 amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1—Amendments

Wholesale/retail client distinction

The amendments in Items 1, 2, 3, 4 and 5 extend the effect of a number of regulations to Part 7.7A of the Act; these regulations currently apply to Parts 7.6, 7.7, 7.8 and 7.9, but *not* Part 7.7A, of the Act.

The amendments are consequential and provide that an Australian Financial Services Licensee (licensee) or representative can treat a person as a wholesale client in Part 7.7A of the Act where the person meets certain specified criteria set out in section 9 or section 761G of the Act.

Item 1 amends the current regulation 7.6.02AB so that paragraph 761G(7)(ca) also applies to Part 7.7A of the Act.

Currently, regulation 7.6.02AB inserts paragraph 761G(7)(ca) into subsection 761G(7) of the Act; regulation 7.6.02AB currently applies to Parts 7.6, 7.7, 7.8 and 7.9 of the Act but not Part 7.7A.

Paragraph 761G(7)(ca) adds an additional criterion for determining whether a person is a retail client. The additional criterion is that, where a product or service is acquired by a company or trust controlled by a person who meets the requirements of subparagraphs 761G(7)(c)(i) or (ii), the company or trust is not considered to be a retail client.

Subsection 761G(7) of the Act specifies certain situations where a client is not considered to be a retail client, and includes circumstances where the financial product is not, or a financial service provided to the client does not relate to: a general insurance product, superannuation product, or retirement savings account product.

Item 2 amends the current regulation 7.6.02AC so that subsections 761G(7A) and 761G(7B) also apply to Part 7.7A of the Act.

Currently, regulation 7.6.02AC inserts subsections 761G(7A) and 761G(7B) into section 761G of the Act; regulation 7.6.02AC currently applies to Parts 7.6, 7.7, 7.8 and 7.9 of the Act but not Part 7.7A.

Subsections 761G(7A) and 761G(7B) add additional criteria for determining whether a person is a retail client; the criteria are in addition to those listed at paragraph 761G(7)(c). The additional criteria enable the person to include the net assets and gross income of a company or trust they control in their net assets or income for the purposes of qualifying to be treated as a wholesale client.

Item 3 amends the current regulation 7.6.02AD so that subsection 761G(4A) also applies to Part 7.7A of the Act.

Currently, regulation 7.6.02AD inserts subsection 761G(4A) into section 761G of the Act; regulation 7.6.02AD currently applies to Parts 7.6, 7.7, 7.8 and 7.9 of the Act but not Part 7.7A.

Subsection 761G(4A) states that, where a financial product or service is acquired by a body corporate as a wholesale client, related bodies corporate of the client are considered to be wholesale clients.

Item 4 amends the current regulation 7.6.02AE so that the change in the definition of 'professional investor' also applies to Part 7.7A of the Act.

Currently, regulation 7.6.02AE substitutes paragraph (e) of the definition of professional investor at section 9 of the Act; regulation 7.6.02AE currently applies to Parts 7.6, 7.7, 7.8 and 7.9 of the Act but not Part 7.7A.

Paragraph (e) of the definition of professional investor, as set out in section 9, provides that a person is considered to be a professional investor if they control assets of at least $10 million including any assets held by an associate or under a trust that the person manages. Regulation 7.6.02AE substitutes paragraph (e) so that a person is considered a professional investor if the person has, or is in control of, gross assets of at least $10 million, including any assets held by an associate or under a trust that the person manages.

Item 5 amends the current regulation 7.6.02AF so that the extended two year renewal period for accountants' certificates also applies to Part 7.7A of the Act.

Where a person elects to be treated as a wholesale client rather than a retail client, paragraph 761G(7)(c) of the Act enables the person to acquire an accountant's certificate that certifies that the person's assets or income are large enough to qualify them as a wholesale client.

Paragraph 761G(7)(c) of the Act requires that the accountant's certificate be renewed at least every six months. However, regulation 7.6.02AF extends the renewal period for accountants' certificates from six months to two years. Regulation 7.6.02AF currently applies to Parts 7.6, 7.7, 7.8 and 7.9 of the Act but not Part 7.7A.

Item 6 repeals a heading that is no longer correct because of these regulations.

Stamping fee provision

Item 11 repeals the existing stamping fee provision under regulation 7.7A.12B and substitutes a new regulation that:

- clarifies the application of the stamping fee provision to remuneration arrangements relating to capital raising activities; and
- broadens the stamping fee provision to include investment entities.

This amendment addresses concerns that the current regulation 7.7A.12B is unclear, and has unintentionally captured transactions that were not meant to be captured by FOFA.

This amendment also addresses concerns that the current regulation creates an inappropriate, market-distorting distinction between the types of entities that are otherwise legitimately permitted to raise capital from retail investors. The current regulation prevents investment entities (that is, entities whose primary purpose is to provide a financial investment) from accessing the stamping fee provision.

This amendment clarifies that, where stamping fees are paid to facilitate capital raising activities involving certain approved financial products, these fees are not captured by the ban on conflicted remuneration — including where these fees relate to capital raising activities undertaken by investment entities.

The new regulation defines a ‘stamping fee’ as:

- a fee (or part of a fee) that a person, including an issuer of a financial product, or a person acting on behalf of the issuer, pays, either directly or indirectly, to a licensee or representative in connection with an offer to issue (or an invitation for an application to issue) the financial product; or
- a similar fee paid in relation to an offer to sell (or an invitation for an application to sell) a financial product.

Under the new regulation, an ‘approved capital raising’ is defined as:

- an offer to issue an approved financial product; or
- an offer to sell an approved financial product;

where the purpose of the offer is to raise funds for the person issuing or selling the approved financial product.

Under the new regulation, the existing definition of ‘approved financial product’ is amended to clarify the application of the provision to certain types of financial products. Specifically, under the new regulation, an approved financial product is defined as:

- debentures, stocks or bonds that are, or are proposed to be, issued by a government;
- shares in, or debentures of, a body that are, or are proposed to be, quoted on a prescribed financial market;
- interests in a managed investment scheme that are, or are proposed to be, quoted on a prescribed financial market; or
- a right to acquire, by way of issue, shares, debentures or interests mentioned above.

Stockbroking-related provisions

Items 12 to 17 extend the brokerage-related provisions to products traded on the ASX24.

ASX24 (the financial market operated by Australian Securities Exchange Limited, formerly known as the Sydney Futures Exchange) is not currently included in the definition of a 'prescribed financial market'. However, the trading that occurs on the ASX24 was never intended to be captured by FOFA; brokerage fees charged for trading on the ASX24 were also not intended to be caught.

Items 12,14 and 16 amend regulation 7.7A.12D so the brokerage fee provision is extended to products traded on the ASX24.

Items 13, 15 and 17 are associated amendments to regulation 7.7A.12D that clarify that the ASX24 is the financial market operated by Australian Securities Exchange Limited, formerly known as the Sydney Futures Exchange.

Balanced scorecard remuneration arrangements

Item 18 inserts regulation 7.7A.12EB to provide that certain performance bonuses for individuals are not conflicted remuneration; these bonuses are commonly referred to as being paid under a 'balanced scorecard arrangement'.

A balanced scorecard arrangement exists where an employee receives remuneration that is calculated by reference to both volume-based and non-volume-based factors. Under section 963L of the Act, any volume-based benefits—and hence balanced scorecard arrangements—are presumed to be conflicted remuneration unless it could be proved that the benefit could not reasonably be expected to influence the product recommended or the financial product advice provided to a retail client.

FOFA always envisaged that balanced scorecard arrangements would be permitted and that employers could rebut the presumption in section 963L.

Some stakeholders have indicated that there is currently legal uncertainty over the ability to make payments using balanced scorecard.

This amendment expressly permits making payments under a balanced scorecard provided the following criteria are met:

- the benefit provided is an element of an individual's remuneration for work done by the individual:
  - as an employee or agent of a licensee; or
  - by arrangement with the licensee under the name of a licensee; and
- access to the benefit, or the value of the benefit, or both, is partly dependent on the total value or number of financial products of a particular class, or particular classes, that:
  - the individual recommends to retail clients or a class of retail clients; or
  - are acquired by retail clients, or a class of retail clients, to whom the individual has provided financial product advice; and
- any part of the benefit that relates to financial products covered by the requirements above, and would—apart from this regulation—be conflicted remuneration, is not considered conflicted remuneration if:
  - the part, together with any other such part that is an element of the individual's remuneration, is low in proportion to the employee's total remuneration; and
  - in calculating the part, the weighting attributed to the total value or number of financial products that are recommended or acquired by retail clients, and in relation to which the part would—apart from this regulation—be conflicted remuneration, is outweighed or balanced by the weighting attributed to other matters.

This regulation does not limit, and has effect in addition to, any other regulation made for paragraph 963B(1)(e) of the Act, and any regulation made for subsection 1528(2) of the Act.

In accordance with ASIC's *Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure*, references to an agent or employee, or otherwise acting by arrangement under the name of a licensee includes: contractors; employees of employment agencies who may be temporarily working for the licensee; employees of a body corporate related to the licensee; and employees of another company who work exclusively for the licensee.

The operation of this regulation is possibly best illustrated by way of example:

Top Finance pays a performance bonus to employees at the end of each financial year provided certain criteria are met. The bonus is comprised of several parts, and is an 'all or nothing' payment, meaning that the criteria for each component must be met in order for the bonus to be paid; part payments in relation to one of the components are not permitted.

For a particular employee of Top Finance, the maximum eligible bonus is $6. This is comprised of:

1) a $1-part in relation to factors that are not captured by FOFA (for example: a bonus paid on a non-financial product such as a home loan);

2) a $2-part that is permitted under a provision of FOFA other than this regulation (for example: the basic banking provision); and

3) a $3-part that is not expressly permitted under any other provision of FOFA (for example: superannuation sales). This $3-part is weighted at 60 per cent for meeting compliance targets and training requirements, and 40 per cent for selling a certain number of products over the year.

The part of the benefit to which this regulation would apply, or be relied upon, is the $3-part of the bonus.

In the example above, the $3-part of the bonus would—in applying this regulation—not be conflicted remuneration if the $3-part was 'low' compared to the employee's total remuneration.

Whilst 'low' is not specifically defined, a benefit is likely to be considered low if it comprises less than 10 per cent of the employee's total remuneration. This calculation is to be applied to the period that the benefit relates to (for instance, if the benefit covers a 12 month period, the benefit would need to be compared to the employee's total remuneration for that same 12 month period).

To continue the above example in assessing whether a benefit is low:

Assume the Top Finance employee has a base salary of $100, and the employee has the potential to receive the bonus of $6 as described above. The employee's total possible remuneration is therefore $106.

Assume that the employee satisfies all of the criteria to receive the bonus.

The $3-part (of the $6 bonus) would be considered low if it made up less than 10 per cent of the employee's total remuneration (of $106). Since 3/106 = 2.8 per cent, the $3-part is considered low thus would be considered not conflicted remuneration and thus the entire bonus of $6 can be paid.

Item 18 also inserts an updated execution-only provision. See Attachment B for more details.

Mixed benefits

Items 23, 24 and 25 clarify the 'mixed benefits' regulation. A mixed benefit is a benefit that relates to more than one activity or service.

Currently, subregulation 7.7A.12I(1) provides that a part of a 'mixed benefit' a that is not conflicted remuneration due to a prescribed provision in the Act will not become conflicted remuneration when mixed with a benefit that relates to other activities or other services, as long as the part of the benefit relating to the other activities or services is also not conflicted remuneration.

For example, assume a $9 benefit is comprised of two parts:

1) *a $4-part that that is not conflicted remuneration as it is in relation to a general insurance product (which by section 963B and regulation 7.7A.12G is not conflicted); and*
2) *a $5-part that is not conflicted because it is not captured by FOFA (for example: for achieving a high customer satisfaction rating).*

Applying subregulation 7.7A.12I(1), the entire $9 benefit is not conflicted.

Subregulation 7.7A.12I(3) prescribes the provisions of the Act to which 7.7A.12I(1) applies. Currently, the prescribed provisions are sections 963B and 963C; sections 963B and 963C specify that certain monetary and non-monetary benefits are not conflicted remuneration.

Section 963D specifies that benefits for recommending basic banking products are not conflicted remuneration. The inclusion of section 963D in subregulation 7.7A.12I(3) ensures that all provisions that specify benefits that are not conflicted remuneration are correctly referenced.

Item 23 provides an example at the end of subregulation 7.7A12I(1) to clarify that the mere payment of two non-conflicted remuneration benefits does not, in and of itself, make the combined payment conflicted.

Item 24 repeals subregulation 7.7A.12I(2) to remove confusion over the operation of the mixed benefits regulation. Concerns have been expressed that the current subregulation 7.7A.12I(2) has created confusion over the operation of subregulation 7.7A.12I(1). In particular, it is argued that subregulation 7.7A.12I(2) unduly restricts the operation of the regulation, so much so that it renders subregulation 7.7A.12I(1) inoperative.

Whilst subregulation 7.7A.12I(2) seeks to restrict the operation of 7.7A.12I(1) so that it can only be applied to the extent that specific exemptions in the Act or regulations permit, this restriction is superfluous as the mixing of benefits can only ever occur to the extent permitted by the Act or regulations.

Item 25 inserts a reference to section 963D of the Act into the definition of 'prescribed provision' at the end of subregulation 7.7A.12I(3). This is a minor technical amendment.

Permissible revenue

Item 26 inserts a new regulation 7.7.12J which provides that benefits that are calculated by reference to the amount or value of a non-conflicted remuneration benefit are themselves not conflicted remuneration. This form of benefit is commonly referred to as 'permissible revenue'.

For this regulation to apply, the 'reference benefit' must be a benefit that is not conflicted remuneration because of section 963B, section 963C or section 963D of the Act.

FOFA always envisaged that payments would not be considered conflicted remuneration if they were made by reference to another benefit that itself is not conflicted remuneration.

Grandfathering arrangements for the ban on conflicted remuneration

Items 28 to 34 make amendments to the grandfathering arrangements for the ban on conflicted remuneration.

The grandfathering arrangements provide that certain benefits that:

- are given under arrangements (typically between product issuers and licensees) entered into prior to the application day (as described in subsection 1528(4) of the Act) of the ban on conflicted remuneration; and
- relate to clients who had interest in the relevant platform or product prior to 1 July 2014;

are not subject to Division 4 of Part 7.7A of the Act.

Separate grandfathering arrangements are provided for benefits given under an employee agreement:

- benefits given under an enterprise agreement are grandfathered up until six months after the nominal expiry date (NED) of the agreement (or grandfathered up until 1 July 2014 for those agreements which passed their NED before 1 July 2013); and
- benefits given under an individual employee agreement are grandfathered up until 1 July 2014.

In summary, if a benefit is characterised as being grandfathered (that is, it is a benefit of the kind described above), the benefit is not subject to Division 4 of Part 7.7A of the Act. Accordingly, the requirement to not accept conflicted remuneration (as mandated by sections 963E, 963G and 963H), and the requirement not to give conflicted remuneration (as mandated by sections 963J and 963K), will not apply in relation to that benefit.

Even though the grandfathering arrangements do not make specific reference to the party receiving the benefit, the grandfathering regulations operate so that once a benefit is "grandfathered", it may be both given and/or received.

Items 28 and 29 insert a new regulation 7.7A.15B and subregulation 7.7A.16(2) to provide that a benefit ("a redirected benefit") will be grandfathered (and not subject to Division 4 of Part 7.7A of the Act) even if it has been redirected under one or more later arrangements.

For a redirected benefit to continue to be grandfathered, the benefit must be one that, when given under the pre-application day arrangement, was not a benefit to which regulation 7.7A.16A, 7.7A.16B or 7.7A.16C applied (that is, was subject to Division 4 of Part 7.7A of the Act because of one of these regulations).

The key objective of items 28 and 29 is to facilitate an authorised representative to continue to receive benefits that would have been grandfathered had the authorised representative not moved licensee. Items 28 and 29 also allow an authorised representative to move licensees more than once and still receive redirected benefits.

For example, items 28 and 29 will allow grandfathering to continue when an authorised representative moves licensees with its client book, and the grandfathered benefits paid to the previous licensee are redirected to the new licensee under an arrangement that was entered into either before, or after the application day. The new licensee may then pass some, or all, of the benefits onto the authorised representative under regulation 7.7A.16F. Items 28 and 29 will also permit grandfathering to continue even if a party becomes a licensee after the application day and the licensee enters into a post-application day arrangement that provides for the giving of a redirected benefit.

It should be noted that, a redirected benefit will *not* fall within regulation 7.7A.15B or 7.7A.16 if it is given on materially different terms to the previous arrangement. As such, the benefit must be given for the same purpose (that is, the benefit must relate to clients who held an interest in the relevant platform or product prior to 1 July 2014), and the benefit must not exceed the benefit given under the previous arrangement.

Item 30 inserts a subregulation 7.7A.16B(5A) to provide that where a retail client elects to switch from the 'growth phase' to the 'pension phase' of the same superannuation interest, the election to switch—or the receipt of the pension—will not be treated as the acquisition of a new financial product for the purposes of regulation 7.7A.16B. This subregulation will allow grandfathered benefits to continue to accrue where the client held the superannuation interests prior to 1 July 2014 and made the election to receive the pension, or commenced receiving the pension, after this date.

Item 31 inserts a new regulation 7.7A.16BA to clarify that when a business is sold, the rights to grandfathered benefits are transferred to the purchaser, who can then receive the ongoing benefit. The purchaser may therefore acquire the same rights to the grandfathered benefits that the seller held prior to the sale taking place. Even though subsection 1528(3) of the Act operates to ensure that rights to grandfathered could be transferred upon the sale of a business, this regulation is required to ensure that businesses have clarity that such benefits can be transferred.

Items 32 to 34 amend the existing regulation 7.7A.16C which provides the grandfathering arrangements for benefits paid under an employee agreement. The amendments extend, by 12 months, the dates at which grandfathering ceases for benefits paid under an employee agreement.

Existing paragraph 7.7A.16F(b) provides that grandfathered benefits may be passed-through to a party that is not subject to the arrangement which gave rise to the grandfathered benefit as long as the benefit is also passed-on under an arrangement entered into prior to the application day.

Item 35 amends existing paragraph 7.7A.16F(2) to provide that a grandfathered benefit may be passed-through to another party if the benefit, as passed-through, was given under an arrangement:

- that was entered into before the application day; or
- by which an authorised representative of one licensee becomes an authorised representative of another licensee after the application day of the ban on conflicted remuneration; or
- a representative (for example, an employee) of a financial services licensee or an employee of an authorised representative of a licensee, became an authorised representative of the same licensee or a related body corporate of the licensee.

The amendment will, for example, allow an authorised representative to change which licensee they are authorised under whilst retaining access to the pass-through of grandfathered benefits. However, the pass-through to the authorised representative can only occur if the new licensee first is given a benefit that is grandfathered because of subsection 1528(1) or a regulation made for subsection 1528(2), noting amendments made by items 28 and 29.

Attachment B

Item 7 inserts regulations that mirror amendments being made to the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, to provide clarity to stakeholders by:

- facilitating scaled advice, and will apply from the time the Regulation commences until 31 December 2015;
- removing the 'catch-all' provision from the list of steps an advice provider may take to satisfy the best interests obligation, and will apply from the time the Regulation commences until 31 December 2015;
- consequential amendments to the modified best interests duty;
- provide that non-cash payment facilities that are not related to a basic deposit product are included in the definition of a 'basic banking product';
- removing the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement), and will apply from the time the Regulation commences until 31 December 2015; and
- removing the requirement to provide an annual fee disclosure statement to clients in ongoing fee arrangements prior to 1 July 2013, and will apply from the time the Regulation commences until 31 December 2015.

Facilitating scaled advice

Regulation 7.7A.2 amends the operation of subsection 961B(2) of the Act to better facilitate the provision of scaled advice. The regulation applies from the time the regulation commences until 31 December 2015.

The regulation substitutes paragraph 961B(2)(a) of the best interests duty—which requires a provider to identify the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions—and replaces it with the same requirement without the words 'through instructions'.

The regulation also inserts two notes: the first note indicates that nothing in section 961B of the Act prevents the provider and a client from agreeing the subject matter of the advice sought by the client. The second note indicates that a provider does not need to inquire into circumstances that would not reasonably be considered as relevant to the subject matter.

The regulation also clarifies that there is nothing in the regulation that prevents a provider and a client from agreeing the subject matter of advice sought. The regulation also inserts an example that indicates that the best interest obligations apply to the advice ultimately sought.

Together, these changes better facilitate scaled advice by clarifying that: an adviser, in considering the information disclosed by their client, is able to agree with their client the subject matter of the advice sought; any investigations into the client's circumstances are

only those that would reasonably be considered as relevant to the agreed subject matter; and the best interest obligations apply to the agreed subject matter.

Removing the 'catch-all' provision

Regulation 7.7A.3 removes the application of the 'catch-all' provision (paragraph 961B(2)(g)) from the list of steps an advice provider may take to show the adviser has satisfied the best interests obligation. The regulation applies from the time the regulation commences until 31 December 2015.

The regulation—in removing the application of paragraph 961B(2)(g)—provides greater certainty to advisers in to demonstrating compliance with the best interests duty.

It is important to note that the best interest duty established by subsection 961B(1) remains—unaltered—in the legislation. Further, it should be noted that the best interest duty from section 961B works in conjunction with related obligations in the law; namely:

- section 961G, which requires the advice to be appropriate;
- section 961H, which requires an adviser to provide a warning if there is any incomplete or inaccurate information;
- section 961J, which requires a provider to prioritise their client's interests ahead of their own; and
- section 961L, which requires licensees to ensure that their representatives are complying with these sections.

These obligations will continue to remain in-place.

Modified best interests duty

The existing regulation 7.7A.1 is repealed and replaced with regulations 7.7A.4 and 7.7A.5, which make consequential changes to the modified best interests duty as a result of the inclusion of consumer credit insurance in the basic banking exemption (see also items 20, 21 and 22). The regulation applies from the time the regulation commences until 31 December 2015.

Currently under subsection 961B(3), an agent or employee of an ADI is not required to satisfy the steps in paragraphs 961B(2)(d) to (g) when the subject matter of the advice sought by the client is solely in relation to a basic banking product. Subsection 961B(4) further provides that a provider need not satisfy those steps when the subject matter of the advice sought by the client is solely in relation to a general insurance product.

In addition, existing regulation 7.7A.1 provides that an agent or employee of an ADI need not satisfy the steps in paragraphs 961B(2)(d) to (g) when the only personal advice provided is in relation to a basic banking product and a general insurance product. Further, a provider need not satisfy paragraphs 961B(2)(d) to (g) to the extent that the subject matter of the advice relates to a general insurance product.

Regulations 7.7A.4 and 7.7A.5 provide that an agent or employee of an ADI need not satisfy the steps in paragraphs 961B(2)(d) to (f) in relation to personal advice on a basic banking or general insurance product where the subject matter sought by the client relates to a basic banking product, general insurance product, consumer credit insurance product, or a combination of these products. These regulations replace regulation 7.7A.1.

To the extent that the subject matter of the advice sought by the client is a general insurance product, the provider need not satisfy the steps in paragraph 961B(2)(d) to (f) in relation to personal advice on a general insurance product. Note: regulation 7.7A.3 removes the need to satisfy 961B(2)(g).

This amendment does not extend the modified best interests duty (under the current law, the need to satisfy the steps in paragraphs 961B(2)(a) to (c) but not paragraphs 961B(2)(d) to (g) in relation to personal advice) to the provision of advice on a consumer credit insurance product; rather, it allows the modified best interests duty to apply to a basic banking product and/or general insurance product where the subject matter of the advice sought also relates to consumer credit insurance.

As such, the provision of advice on a consumer credit insurance product still requires all the steps in subsection 961B(2) (the best interests duty) to be satisfied, where the provider chooses to rely on those steps to satisfy the best interests duty.

Definition of a basic banking product

Regulation 7.7A.6 provides that a facility for making non-cash payments that is not related to a basic deposit product is a basic banking product for the purposes of section 961F of the Act.

Remove opt-in requirements

Regulation 7.7A.7 removes the application of the requirement for a fee recipient to send a fee renewal notice to a client (the 'opt-in' requirement). The regulation applies from the time the Regulation commences until 31 December 2015.

Currently, the Act requires a licensee with an ongoing fee arrangement with a retail client that commenced after 1 July 2013 to obtain their client's agreement at least every two years to continue the ongoing fee arrangement. If, after receiving the renewal notice, the client decides not to renew or fails to respond to the fee recipient's renewal notice, the ongoing fee arrangement terminates.

Fee disclosure statements prospective only

Regulation 7.7A.8 makes the requirement for advisers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013. The regulation applies from the time the Regulation commences until 31 December 2015.

Currently, the Act requires licensees to give all retail clients with an ongoing fee arrangement a fee disclosure statement that shows the fees paid by the client, the services the client received, and the services the client was entitled to receive, in the previous 12 months.

The regulation removes the fee disclosure requirement for pre-1 July 2013 clients; post-1 July 2013 clients will continue to receive fee disclosure statements.

Broadening the basic banking provision

Items 20, 21 and 22 broaden the existing 'basic banking provision to include all 'Tier 2' products.

ASIC, in its training guidelines, makes a distinction between 'Tier 1' and 'Tier 2' products: Tier 2 products are generally considered simple in nature and therefore require less onerous training when providing advice than Tier 1 products. Tier 2 products include basic banking products, general insurance products, and consumer credit insurance products. Tier 1 products include all other financial products not listed in Tier 2 (for example, managed investment schemes and superannuation).

Currently, section 963D of the Act provides that benefits are not conflicted if they relate to a basic banking product as long as the agent or employee of an ADI—at the time of providing advice on the basic banking product—does not provide financial product advice on any other financial product. Further, regulation 7.7A.12H currently allows access to the exemption where the agent or employee also provides financial product advice on a general insurance product.

The amendments enable the benefit given to the agent or employee of an ADI to also relate to a consumer credit insurance product. Further, the amendments allow the agent or employee to provide personal advice on a consumer credit insurance product at the same time as providing advice on a basic banking product and/or general insurance product. In order to benefit from the exemption, the agent or employee cannot provide personal advice on any other financial product.

In accordance with ASIC's *Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure*, references to an agent or employee, or otherwise acting by arrangement with an Australian ADI under the name of an Australian ADI includes: contractors; employees of employment agencies who may be temporarily working for the Australian ADI; employees of a body corporate related to the Australian ADI; and employees of another company who work exclusively for the Australian ADI.

Intra-fund advice

Item 8 inserts a note at the end of regulation 7.7A.10 to clarify that the term 'intra-fund advice' refers to a type of financial product advice provided to a member of a regulated superannuation fund by a trustee of the fund, or by persons under an arrangement with the trustee of the fund.

The note links the commonly used term with the rules under section 99F of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), which deal with the subject area.

In particular, the note clarifies that intra-fund advice is not advice of the kind to which the cost of providing the advice is prohibited from being collectively levied under section 99F of the SIS Act.

Client-pays provision

Items 9 and 10 clarify the operation of the client-pays provision by inserting notes that explain their operation.

Under the Act, paragraph 963B(1)(d) provides that benefits given by a retail client to a licensee or representative in relation to the issue or sale of a financial product or financial product advice are permitted.

In addition, section 52 of the Act provides that: ‘a reference to doing an act or thing includes a reference to causing or authorising the act or thing to be done’. As Paragraph 963B(1)(d) exempts a benefit from conflicted remuneration if it is ‘given’ to a licensee or representative, applying section 52 would mean that in giving a benefit to a licensee or representative, a retail client is also causing or authorising the benefit to be given.

The regulation inserts a note at the end of regulation 7.7A.12 that clarifies that section 52 of the Act also operates in relation to the conflicted remuneration provisions of Division 4 of Part 7.7A of the Act.

The note clarifies that a benefit may be given either directly by a client or given by another party at the direction of the client; as long as the benefit is given using the client’s own monies, or funds the client is beneficially entitled to, the client-pays exemption applies.

Concerns have been raised over whether the client-pays provision can be used to permit payments made from a superannuation fund member’s balance. The regulation clarifies that such payments can occur. The regulation inserts a note at the end of regulation 7.7A.12 that specifically indicates that the client-pays exemption operates with respect to advice paid from a superannuation fund member’s fund balance. This principle also applies to other investments of the client, such as a platform or a managed investment scheme.

The trustee of the superannuation fund must still consider whether payments out of the client’s superannuation fund is appropriate given the trustee’s other obligations, such as the sole purpose test under section 62 of the SIS Act.

It is important to note that, where the benefit is given by another party, it must be given with the client’s clear consent. A client would not be considered to have given clear consent if the consent was not clearly and expressly sought; for example, where consent has been sought as part of a broad range of terms and conditions agreed by the client in aggregate, clear consent would not have been provided. Rather, a client’s consent could be expressly sought in a separate and distinct section of the terms and conditions agreed by the client.

Benefits given by another party at a client’s direction are not given by the client if the benefits are borne out of the other party’s funds.

Execution-only services

Item 18 inserts Regulation 7.7A.12.EC that provides that benefits for 'execution-only services' are permitted, which, in comparison with paragraph 963B(1)(c), provides a closer nexus between the party receiving the benefit and any advice that might have been provided in relation to the product being issued or sold to the client.

Currently, paragraph 963B(1)(c) of the Act permits a benefit if it is given in relation to the issue or sale of a financial product and the licensee or representative has not provided financial product advice to the client in relation to the product—or products of that class—in the previous 12 months.

Under the regulation, the execution-only provision will apply if a monetary benefit is given in relation to the issue or sale of a financial product and the licensee or representative receiving the benefit has not provided financial product advice to the client in relation to the product that is to be issued or sold—or advice on a class of financial products, of which the product is one—in the previous 12 months.

Item 18 also specifies that certain performance bonuses for individuals are not conflicted remuneration. See Attachment A for further detail on this item.

General advice

Item 19 inserts regulation 7.7A.12F, which specifies that benefits paid in relation to general advice are not conflicted remuneration as long as certain conditions are met. The regulation also clarifies that certain payments, commonly known as commissions, are not permitted.

Under the current law, remuneration (both monetary and non-monetary) received in relation to the provision of both personal advice (financial product advice that takes into account the client's objectives, financial situation and needs) and general advice (financial product advice that does not take into account the client's objectives, financial situation and needs) is captured by the ban on conflicted remuneration.

The Government considers that the current application of the ban on conflicted remuneration imposes unnecessary burdens on industry. However, it is important to note that it was never the Government's intention to allow the payment of commissions on general advice. To this end, the general advice provision is targeted, and is comprised of five limbs; all five limbs must be satisfied for the benefit to not be considered conflicted remuneration. Importantly, there is a specific limb that clarifies—beyond a doubt—that payments known as commissions cannot be paid.

The five limbs to the general advice provision are:

1) The "employee" limb: this limb ensures that only employees or persons in "employee-like" situations are eligible to utilise the provision. The limb identifies three employee scenarios that are permitted:

- an employee of the licensee, or a related body corporate of the licensee;
- an employee of an authorised representative of the licensee; or

- an individual who has been sub-authorised under section 961B of the Corporations Act by an authorised representative of the licensee to give general advice on behalf of the licensee of the kind given.

2) The "name of the licensee" limb: this limb restricts the employee limb by requiring the employee to provide general advice under the name of the licensee, a trade mark of the licensee, or a business name of the licensee. The term trade mark of a licensee means a trade mark of which the licensee is the registered owner under the *Trade Marks Act 1995*, and the business name of a licensee means a business name that is registered to the licensee under the *Business Names Registration Act 2011*.

Both the employee and name of the licensee limbs ensure that it is clear that the general advice is provided by an employee working for the licensee under the licensee's name, trade mark or business name.

3) The "no commissions" limb: this limb clearly indicates that the general advice provision does not permit payments commonly known as commissions. This limb indicates that two types of payment are not permitted:

- a recurring payment made because the person has given the general advice, and
- a payment made solely because a financial product of a class in relation to which the general advice was given has been issued or sold to the client.

The two payments are—respectively—broadly consistent with what are commonly referred to as a trail commission and an upfront commission.

It is important to note that neither the no commissions limb, nor the general advice provision, prevents the payment of a salary or a performance benefit (such as a performance bonus paid subject to a balanced scorecard).

The reference to "solely" means that "per product" payments—such as a benefit of $1 for each product issued-or-sold as a result of general advice given—are not permitted. However, if an employee were required to meet a reasonable performance target—such as selling 1,000 products—as well as a compliance target for the incentive payment to be paid, the payment would not be made *solely* because of the general advice: the performance and compliance targets would also have been satisfied; consequently, such a payment would be permitted.

It should be noted that a payment structured in a manner that, prima facie, is not *solely* because of the general advice may—still—not be permitted. For example, if the payment were in relation to a performance target that would not be seen as reasonable, the payment may be seen to have been made *solely* because of the general advice and thus would not be permitted.

The reference to "financial products of a class" prevents benefits on general advice given on a class of products where that general advice results in a product of that class being issued or sold to the client. As such, regardless of whether general advice were provided on an entire class of financial product, three financial products of the same class, or a single financial product, as long as the payment is made solely because a financial product of a class in relation to which the general advice was given is issued or sold to the client, the payment is not permitted.

4) The "no personal advice" limb: this limb restricts the advice that can be provided in the preceding 12 months. The limb specifies that, during the 12 months immediately before the benefit was given, the employee must not have given financial product advice to a retail client other than:

– general advice; or

– personal advice in relation to basic banking products, general insurance products, and consumer credit insurance products; or

– a combination of the advice mentioned above.

The general advice provision operates seamlessly with the existing provision that allows benefits to be paid in relation to basic banking products, general insurance products, and consumer credit insurance products (the "basic banking provision").

The no personal advice limb precludes persons who provide personal advice across classes of financial products—commonly referred to as financial planners or financial advisers—from utilising the general advice provision.

5) The "allowable products" limb: this limb ensures that the general advice provided by an employee is in relation to a financial product issued or sold by the licensee. To utilise the general advice provision, the financial product in relation to which the general advice is given must either be:

– a product issued or sold by the licensee or a related body corporate of the licensee; or

– a product issued or sold by another entity under the name of the licensee, a trade mark of the licensee or a business name of the licensee.

Education and training in conducting a financial services business

Item 27 inserts regulation 7.7A.15A to prescribe circumstances in which a non-monetary benefit given to a financial services licensee, or a representative of a licensee, who provides financial product advice to persons as retail clients is not conflicted remuneration.

Paragraph 963C(c) currently provides that a non-monetary benefit that has a genuine education or training purpose relevant to the provision of financial product advice to retail clients is not conflicted remuneration.

The item specifies that a non-monetary benefit is not conflicted remuneration if the benefit:

- has a genuine education or training purpose; and
- is relevant to the carrying on of a financial services business; and
- complies with any regulations made for the purposes of subparagraph 963C(c)(iii) of the Act (currently, regulations 7.7A.14 and 7.7A15 are made for the purposes of subparagraph 963C(c)(iii)).

This regulation will allow education and training on a broader range of topics to be provided under the ban on conflicted remuneration.

Attachment C

REGULATION IMPACT STATEMENT

Introduction to FOFA

What is FOFA?

Summarily, the Future of Financial Advice (FOFA) legislation—part 7.7A of the *Corporations Act 2001* (the Act)—imposes the following standards on providers of financial advice:

1) A best interests obligation that requires advisers to act and provide advice that is in the best interests of their client;

2) An obligation to disclose ongoing fees and charges paid by their client; and

3) A requirement to not accept payments that may influence the advice provided to the client.

Each of these requirements is discussed in greater detail later in this Regulation Impact Statement (RIS).

FOFA represents the former Government's response to the recommendations of the "Ripoll Inquiry", a Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into financial products and services in Australia. The Ripoll Inquiry was set up in 2009 to inquire into, and report on, issues associated with financial products and services provider collapses that occurred in the wake of the Global Financial Crisis (GFC).

The dual underlying objectives of FOFA are to:

1) improve the quality of financial advice;

2) increase trust and confidence in the financial advice industry.

Why is FOFA changing?

The current Government agrees with the policy intent of FOFA, but considers that the legislation has, in parts, placed an unnecessarily heavy compliance burden on the financial services industry.

When the FOFA legislation was first introduced to Parliament in late 2011, Parliament referred the then Bills—FOFA was introduced in two tranches[1]—to the PJC; a report on the PJC's inquiry was released in early 2012.

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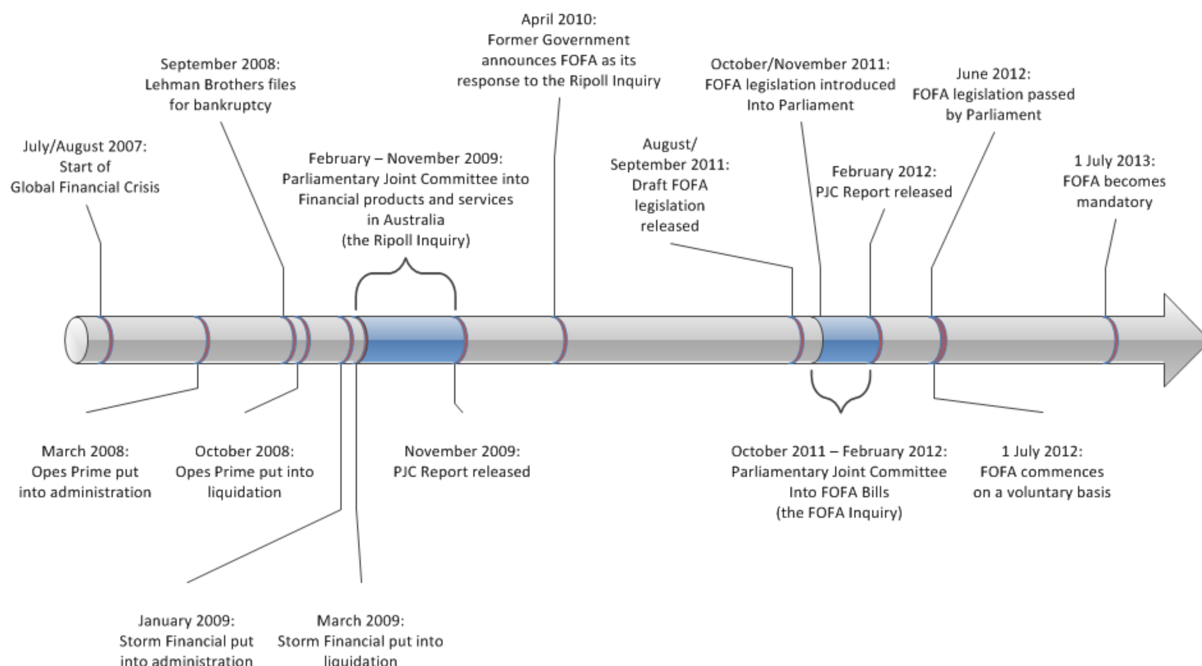
[1] Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

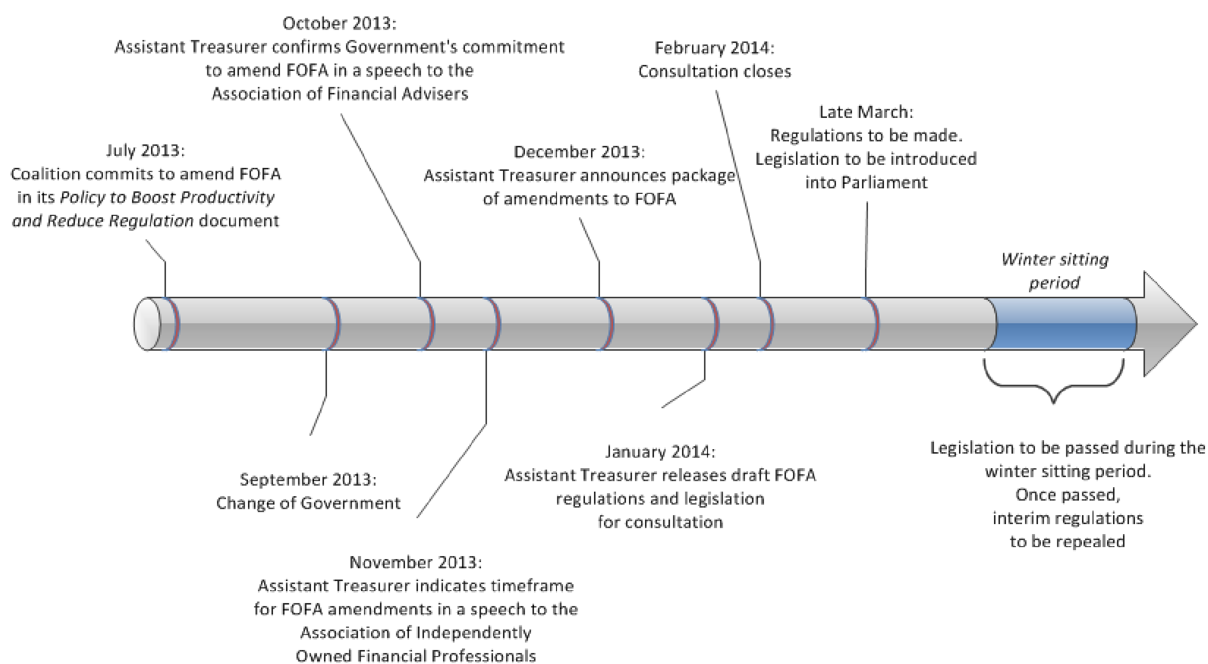
Alongside the main PJC report was a Dissenting Report by the Coalition members of the PJC (the Dissenting Report). The Dissenting Report contained a number of recommendations to reduce the regulatory burden the FOFA Bills were predicted to impose on the financial services industry.

Timeline of FOFA

Graphic 1: FOFA history



Graphic 2: FOFA amendments

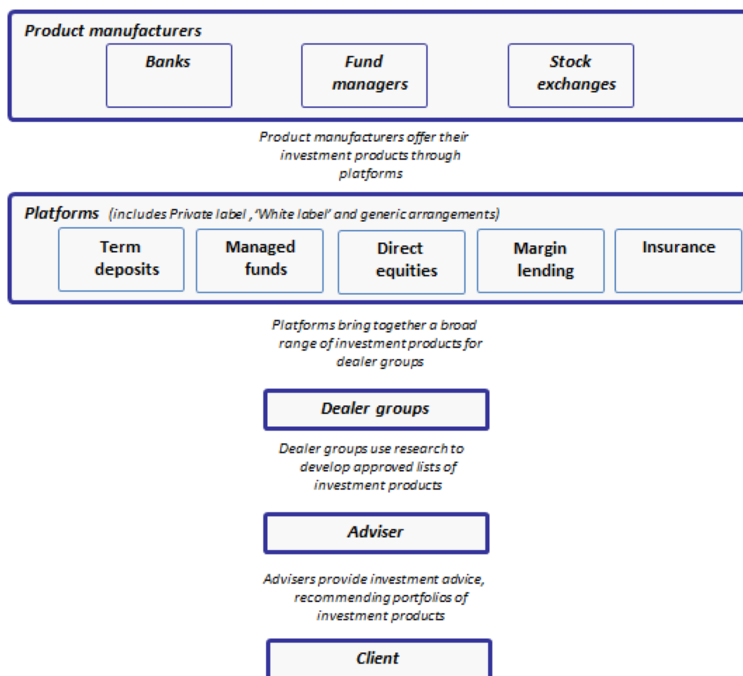


Overview of the financial services industry

The financial services industry is an important part of the Australian economy; it currently employs over 400,000 people and is the largest industry in Australia when measured by gross value added (a measure of the economic worth of the goods and services produced)[2]. Continued industry growth is expected to be largely driven by Australia's ageing population and the increasing pool of superannuation funds.

The structure of the financial services industry is represented in Graphic 3.

Graphic 3: Structure of financial services industry



Product manufacturers, or fund managers, are responsible for creating and managing financial products. Australia's managed funds industry is one of the largest in the world, and the majority of these funds are attributable to the advanced superannuation system, which encourages employees to save for retirement throughout their working life. The pool of superannuation funds in Australia is roughly the same size as Australia's economy[3].

Platforms act as intermediaries between product manufacturers and dealer groups. A product manufacturer will typically place their financial products on a platform to make their products accessible to dealer groups. A dealer group is made up of multiple representatives who are authorised by a licensee to provide financial advice under that licensee's financial services licence. In Australia, there are more than 750 dealer groups[4] who compare and assess financial products on platforms and select a range of products (commonly referred to as an 'approved product list') for their aligned advisers to offer to their clients. Dealer groups also offer a range of other services, including back-end support and administrative functions.

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[2] ABS - 5204.0 - Australian System of National Accounts, 2012-13.
[3] ABS - 5206.0 - Australian National Accounts: National Income, Expenditure and Product, June 2013.
[4] ASIC *Report 224: Access to financial advice in Australia*, 2010, p30.

Industry estimates indicate that there are around 18,000 financial advisers in Australia[5], who collectively manage over $500 billion of funds under advice and generate over $4 billion revenue per annum[6]. Between 20 and 40 per cent of Australian adults use or have used a financial adviser[7].

The financial advice industry is stratified into three distinct segments: large, medium and small firms. There are five large firms, all of which directly employ over 1,000 financial advisers. These large firms are also financial product manufacturers and offer platform services. Medium sized firms employ between 60 and 1,000 advisers, and small firms employ less than 60 advisers. Many, but not all, of the small and medium sized firms are aligned with one of the larger firms, often using the platform(s) of a large firm to access and manage financial products for their clients.

The industry is relatively competitive, with around half the market accounted for by the top five firms, and the remaining half occupied by small and medium firms[8]. Whilst there are some impediments for consumers switching financial products and advisers, the competitive nature and the need for advisers to act in the best interests of their clients ensures that clients have the ability to switch products and advisers.

Increase in Institutional Ownership

The introduction of FOFA, along with the impact of the GFC, appears to have had a sizable impact on the industry. The FOFA amendments led many dealer groups to review their remuneration models and business entity structures in light of the shift to fee for service and the ban on conflicted remuneration. The outcome has been that, since 2008, there have been a number of major dealer group purchases, with more than a quarter of advisers changing their home licence since 2008.

Many of these groups merged with, or were purchased, by wealth management groups, with institutional ownership of the financial advice market now controlling the majority of the market. Five advice conglomerates now control more than half of the advice market.

Industry consolidation is being driven by the economies of scale achieved by having a large number of advisers within the same group. This includes the opportunity to distribute financial products through a greater number of aligned advisers. ASIC has expressed concerns about the number of the largest dealer groups being owned by product issuers, which may give rise to perceived or actual conflicts of interest[9]. In addition, smaller groups which have found it difficult to adapt to FOFA have proven to be easy and desirable targets for larger groups[10]. The barriers to entry in the industry relate mainly to holding and complying with licensing requirements, which have increased since FOFA, and achieving a sufficient scale to be competitive[11].

[5] ASIC *Report 224: Access to financial advice in Australia*, 2010, p30.
[6] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.
[7] ASIC *Report 224: Access to financial advice in Australia*, 2010, p14.
[8] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.
[9] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p7.
[10] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.
[11] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.

Impact of FOFA

While the industry was growing rapidly before the GFC, the economic downturn in 2008 and the FOFA amendments have led to a decline in financial adviser numbers. More recently, dealer group numbers appear to have increased and funds under advice have remained relatively stable, especially compared with the decline following the GFC. It is likely that the concentration within the industry and FOFA amendments encouraged advisers to either move to other licensees or to establish themselves under their own licence.

As revenue has remained relatively steady but compliance and servicing costs increased because of the FOFA amendments, there has been a decline in the industry's performance. AMP, for example, estimated the reduction in embedded value in financial year 2013 because of FOFA at $176 million in respect of anticipated margin impact and the remaining cost of implementing FOFA at $4 million in financial year 2014[12]. The Commonwealth Bank also increased its spend on risk and compliance projects by 24 per cent in 2013 compared with 2012 which was, in part, to satisfy FOFA amendments[13].

The fall in adviser numbers also implies that the industry has been underperforming population growth. This raises concerns as the industry tries to service more people, particularly amongst the baby boomers heading into retirement. The decline in adviser numbers is also likely to be a reason behind the merger and acquisition activity in the industry, as groups develop alternative pathways for expanding. Industry employment is predicted to remain flat as uncertainty leads to career changes and a pause in recruitment[14].

Driving Efficiencies

The relative stagnation in the advice industry and the costs associated with FOFA has encouraged advisers and dealer groups to gain efficiencies through software and other tools. Industries servicing the advice industry, including platforms and software providers, have been under increasing pressure to provide these efficiencies.

Platforms

Platforms are administrative systems used by advisers for their clients. The big four banks plus AMP and Macquarie control most of the market. To capture and retain market share, platforms have been focusing on technological advances such as share trading capability.

Adviser groups often use a number of platforms to serve different needs, but with consolidation in both the platform and advice industries by leading players, there is an increasing push from these players for their own, or aligned, advisers to use their own 'white label' platforms rather than external platforms[15].

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[12] *AMP Investor Report: Full Year 2013,* AMP, 2014, available from: http://shareholdercentre.amp.com.au/phoenix.zhtml?c=142072&p=irol-reports, p27, 39. This is the impact of FOFA as well as other regulatory changes, including the Stronger Super reforms.

[13] *Annual Report 2013*, Commonwealth Bank, 2013, available from: https://www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/annual-reports/2013_CBA_Annual_Report_19_August_2013.pdf, p15.

[14] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.

[15] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p13.

Research providers

As a condition of their licence, advisers are required to demonstrate why they recommended particular products to their clients. This research often informs the formulation of Approved Product Lists (APLs). Sometimes a second subsidiary list is created from the APL, a Recommended Product List (RPL), which lists the products recommended for advisers to use at that point in time. Almost all licensees outsource this research to external research providers, often to more than one provider[16]. ASIC has noted that advisers should perform due diligence on potential external research providers, so that they understand the research provider's business model and can take that into account when providing advice to clients[17]. Under FOFA, where an advice provider considers it reasonable to recommend a financial product they must conduct a reasonable investigation into products relevant to the subject matter of the advice and assess the information gathered in the investigation[18].

There are only around a dozen research providers in Australia. The market is very concentrated, with the top five research providers controlling almost 90 per cent of the market. Fund managers now try to strategically target advisers through the research providers they have contracted. Research providers are therefore important gate-keepers, deciding which products meet the standards required by advisers[19].

A 2011 ASIC review of the top 20 advice licensees found that despite the median number of products on approved product lists being around 400, there remained a tendency to concentrate product recommendations into a few key products[20]. This is relevant to any regulation of the remuneration models used by dealer groups.

Remunerations Models

Aspects of FOFA, including the ban on conflicted remuneration, the introduction of scaled advice and the best interests duty, have led to a widespread shift to fee for service payments. This shift has been noticed by ASIC, and it was an anticipated consequence of FOFA[21]. Some groups, most notably MLC/NAB Wealth and AMP[22], have been moving to a fee for service model for several years, but the trend has become more pronounced since FOFA.

This shift is evident in two ASIC surveys of licensees conducted in 2011 and 2013. A 2011 ASIC review of the top 20 advice licensees found that the majority remunerated their advisers based on the volume of financial products sold, which included ongoing commissions, up-front commissions and volume rebates[23]. In regards to total licensee remuneration, 90 per cent was paid by product providers (including asset-based fees), and only 10 per cent were paid directly by clients[24].

Significant product concentration was also evident in the fees received by advisers. Ongoing commissions from the top three products recommended by all 20 licensees represented

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[16] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p27.
[17] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p28.
[18] Section 961B(2)(e) of the *Corporations Act 2001* (Cth).
[19] *Regulatory Guide 79: Research report providers: Improving the quality of investment research*, ASIC, December 2012, available from: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg79-published-10-December-2012.pdf/$file/rg79-published-10-December-2012.pdf, p1.
[20] ASIC *Report 251*: *Review of financial advice industry practice*, 2011, p7.
[21] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p13.
[22] *Annual Review 2011*, NAB, 2011, available from: http://cr.nab.com.au/docs/2011annualreview.pdf, p20.
[23] ASIC *Report 251*: *Review of financial advice industry practice*, 2011, p11.
[24] ASIC *Report 251*: *Review of financial advice industry practice*, 2011, p11.

37 per cent of all ongoing fees. Further, 43 per cent of all up-front commissions were received from the top three recommended products[25].

In contrast, in a 2013 ASIC review of the top 21 to 50 licensees, 11 received less than 5 per cent of their remuneration directly from clients, two received over 90 per cent of their remuneration directly from clients. On average, approximately 36 per cent of revenue was received directly from clients[26].

The impact of the proposed reforms on remuneration models within the industry is uncertain at this stage. There has been only limited public comment from the industry on their future plans, although AMP has ruled out reintroducing commission payments on its investment and superannuation products[27].

The impact of FOFA on the cost of financial advice is not yet evident. It is possible that groups absorbed compliance costs – instead of passing these costs onto consumers – to retain clients and maintain market share. A handful of licensees have been FOFA-compliant for longer than was mandated, giving them the opportunity to transition and spread their compliance costs over a longer time frame.

In general, ASIC has found that the fees charged for advice can vary significantly across advice providers[28]. In 2010, licensees reported an estimate of the cost of providing comprehensive financial advice to a client in the range of $2500 to $3500[29]. IBISWorld also reports fees of around $2,500 to receive holistic advice from an adviser[30].

Importantly, ASIC found that a significant gap exists between what consumers are prepared to pay for financial advice and how much it costs industry to provide advice. This is the case even though high net worth clients often cross-subsidise lower value clients[31]. This gap existed prior to the FOFA amendments and would only have been exacerbated by the compliance costs imposed by FOFA, although this is hard to quantify at this stage.

The FOFA amendments were expected to increase the provision of scaled advice, that is advice limited to a particular product or range of products. The number of advisers providing scaled advice was expected to rise from 2 to 2.5 percent in 2013-14 to between 10 and 15 per cent in 2018-19, as scaled advice is often cheaper to provide than holistic advice under a shift to a fee for service model[32]. The proposed explicit provision of scaled advice will further facilitate this growth trend.

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[25] ASIC *Report 251*: *Review of financial advice industry practice*, 2011, p12.
[26] ASIC *Report 362: Review of financial advice industry practice: Phase 2*, 2013, p13.
[27] Kate Kachor, 'AMP rules out commissions revival', *Financial Observor*, 21 February 2014 (online), available from: http://www.financialobserver.com.au/articles/amp-rules-out-commissions-revival.
[28] ASIC *Report 224: Access to financial advice in Australia*, 2010, p43.
[29] ASIC *Report 224: Access to financial advice in Australia*, 2010, p42.
[30] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.
[31] ASIC *Report 224: Access to financial advice in Australia*, 2010, p44.
[32] IBISWorld Industry Report K6419b *Financial planning and investment advice in Australia, August 2013*.

Significance of the problem to be addressed

The Ripoll Inquiry

To understand the significance of the problem to be addressed, it is important to understand the history and context of FOFA. As noted in the introduction, and shown in Graphic 1: FOFA history, the current FOFA legislation was a response by the former Government to the findings of the Ripoll Inquiry

The Ripoll Inquiry was set up in 2009 to inquire into, and report on, issues associated with financial products and services provider collapses, such as Storm Financial, Opes Prime, with particular reference to the role of financial advisers; the general regulatory environment for financial products and services; the role played by commission arrangements relating to product sales and advice, including: the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers; and the appropriateness of information and advice provided to consumers considering investing in products and services, and how the interests of consumers can best be served.

The Ripoll Inquiry released its report in November 2009 and made 11 recommendations for reform. The report commented: "It is the view of the committee that, if implemented, these changes will act in synergy to provide better outcomes and protections for consumers of financial products and services"[33].

FOFA

Most of the recommendations from the Ripoll Inquiry were adopted by the former Government and formed the basis of FOFA. In some areas, FOFA went further than the Ripoll Inquiry recommendations and imposed additional requirements not canvassed. Table 1 summarises select recommendations from the Ripoll Inquiry that subsequently became part of FOFA, as well as additional measures introduced as part of the original FOFA legislation.

Table 1: Select Ripoll Inquiry recommendations and FOFA

Ripoll Inquiry recommendation	FOFA response	Concerns with FOFA
Recommendation 1: That the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an AFSL, requiring them to place their clients' interests ahead of their own.	Introduce a **statutory best interests duty**—Division 2, Part 7.7A—which requires an advice provider to: • act in the best interests of the client; • provide advice that is appropriate to the client; • warn the client if the advice is based on incomplete or inaccurate information; and • if there is a conflict between the client's interests and those of the advice provider,	• The current provision is unclear and labour-intensive due to its open-ended nature. • It has also created significant legal uncertainty as to how advisers can actually satisfy the best interests duty.

[33] PJC Inquiry into financial products and services in Australia, November 2009, p150.

Ripoll Inquiry recommendation	FOFA response	Concerns with FOFA
	give priority to the client's interests.	
Recommendation 4: That the government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers.	Introduce a **ban on conflicted remuneration**—Division 4, Part 7.7A—which bans benefits, whether monetary or non-monetary, given to advisers in relation to advice that could reasonably be expected to influence either the choice of financial product recommended or the financial product advice given. Some exemptions from this ban were introduced, including for basic banking products.	• The current ban captures activities that were not the objective of FOFA. • The financial advice industry is required to maintain complex systems when providing general advice to ensure compliance with the existing conflicted remuneration provisions.
Not included in recommendations	Introduce an **opt-in requirement**—Division 3, Part 7.7A—which requires an adviser to seek, every two years, their client's consent to continue an ongoing fee arrangement.	• The opt-in notices do not arguably offer substantial benefits to consumers; particularly as consumers already have the ability to opt-out of their arrangements. • This requirement has imposed significant implementation and ongoing costs on advisers.
Not included in recommendations	Introduce a **fee disclosure statement**—Division 3, Part 7.7A—which requires an adviser to provide, every year, a statement that shows the fees paid by the client, the services the client received and the services the client was entitled to receive during the preceding 12 months.	• Providing fee disclosure statements to pre-1 July 2013 clients has proven to be difficult and expensive. • Many of these clients are on old legacy systems, predating the FOFA changes; as such, significant manual work is required to prepare statements for these clients.

Dissenting Report

Upon introduction to Parliament, the FOFA Bills were referred to the PJC for inquiry and report. Alongside the PJC's report into the FOFA Bills was the Coalition's Dissenting Report. The Dissenting Report affirmed the Coalition's commitment to the recommendations of the Ripoll Inquiry, but criticised the former Government's proposed legislation. The Dissent Report comments:

> …in pursuing regulatory change the Parliament must focus on making things better not just more complex and more costly for everyone. The Parliament must avoid regulatory overreach where increased red tape increases costs for both business and consumers for little or no additional consumer protection benefit[34].
>
> …
>
> …the Ripoll Inquiry reported back in November 2009 and made a number of well considered and reasonable reform recommendations[35].
>
> …
>
> …Instead of implementing the very sensible and widely supported recommendations made by the Ripoll Inquiry, the government allowed its Future of Financial Advice reform package to be hijacked by vested interests creating more than two years of unnecessary regulatory uncertainty and upheaval in our financial services industry.
>
> The government's decision making processes around FOFA over the past two years leave much to be desired. There were constant and at time completely unexpected changes to the proposed regulatory arrangements under FOFA right up until the introduction of the current legislation. Invariably this was done without proper appreciation or assessment of the costs involved, of any unintended consequences or other implications flowing from the proposed changes to the changes.
>
> Important financial advice reforms recommended by the Ripoll inquiry have been delayed by more than two years so the government can press ahead with a number of additional contentious changes.
>
> It is the view of Coalition Committee members that the FOFA package of legislation in its current form is:
>
> - Unnecessarily complex and in large parts unclear;
> - Expected to cause increased unemployment;
> - Legislating to enshrine an unlevel playing field amonst advice providers, inappropriately favouring a government friendly business model; and
> - Likely to cost about $700 million to implement and a further $350 million per annum[36] to comply with, according to conservative industry estimates.

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[34] Dissenting Report, February 2012, p151.

[35] Dissenting Report, February 2012, p151.

[36] The cost estimate was indicated to be $375 million by Mr John Brogden, CEO of the Financial Services Council, during PJC hearings.

> Based on the evidence provided to the Committee, Coalition Committee members conclude that this will lead to increased costs and reduced choice for Australians seeking financial advice. [37]

The Dissenting Report went further to indicate that FOFA would have a widespread, detrimental effect on the financial advice industry. The Dissenting Report continues:

> The Committee received evidence from many industry participants about the very serious detrimental effects the introduction of this legislation in its current form would have on the industry and on consumers. Detrimental effects include high additional costs imposed on industry participants with resulting increased costs of advice for consumers, reduced employment levels in the financial services sector leading to reduced availability and access to affordable high quality advice, as well as a further concentration of advice providers which would lead to an undesirable reduction in competition and choice for consumers[38].
>
> …
>
> Stakeholders argue that FOFA, if passed in its current form, would cause an undesirable restructuring of the financial advice industry, with increased concentration of players in the market and less competition[39].
>
> …
>
> Coalition Committee members consider that the disproportionate increase in costs to the industry and consumers, the reduction in the number of financial advisers in Australia, the associated additional job losses and the further concentration of financial advice services providers will have detrimental impacts on the cost, availability and accessibility of financial advice across Australia[40].

The Dissenting Report made 16 recommendations that would address the Coalition Committee members' concerns with FOFA.

FOFA today

There is evidence[41] to suggest that some of the concerns raised in the Dissenting Report have eventuated. There has been some evidence—depending on reporting sources—of a decline in adviser numbers in recent years. There has also been evidence of increasing industry concentration—particularly through the consolidation of smaller dealer groups with large institutional advisers; it is reasonable to conclude that such a concentration may result in less competition and choice available to consumers.

During consultations undertaken on the proposed package of amendments to FOFA, as well as on the draft legislation and regulations, a number of industry stakeholders have indicated that they have incurred, and will continue to incur, significant ongoing costs to satisfy the

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[37] Dissenting Report, February 2012, p152-153.
[38] Dissenting Report, February 2012, p154.
[39] Dissenting Report, February 2012, p155.
[40] Dissenting Report, February 2012, p156.
[41] Much of the evidence in this RIS has been provided to the Treasury under commercial-in-confidence arrangements and cannot be directly quoted. Where this is the case, the evidence is paraphrased and no source is referenced.

compliance requirements imposed by FOFA. However, it is currently unclear whether this has translated into higher costs for consumers. Similarly, it is unclear whether FOFA has resulted in reduced availability and accessibility of financial advice. Given the short time since FOFA became mandatory, and given the continuing adjustments that are taking place in the industry, these outcomes may not be known for some time.

Looking forward

The changes the Government intends to make to FOFA should be considered against the backdrop of an ageing population, declining workforce participation and the need for increased fiscal discipline.

The *Australia to 2050: future challenges* report shows that the proportion of Australia's population aged 65 and over is projected to almost double over the next 40 years[42]. The increased value of individuals' superannuation and other private assets represent a significant business opportunity for advisers. Superannuation and retirement products currently comprise the majority of the wealth management market, so growth in this area will have a significant positive impact on the industry.

While there will be an increase in the number of retirees to advise, the number of advisers in industry in recent years has stagnated or declined slightly. Some industry stakeholders have attributed this to increased costs and uncertainty arising from FOFA. Reducing the compliance burden on the industry will free up more resources, and should facilitate job creation and innovation, which will support productivity and result in more efficient processes.

Higher spending on public health care, pensions and other social services caused by population ageing will also result in higher fiscal pressures on the government. One guiding principle for achieving fiscal sustainability is that government should "do for people what they cannot do, or cannot do efficiently, for themselves, but no more"[43]. Financially self-reliant individuals will reduce the pressures on government spending, and encouraging Australians to take responsibility for their own financial decisions will become increasingly important. The proposed changes to FOFA will foster an environment where affordable financial advice is more accessible, which will encourage wealth creation.

In summary, the changes to FOFA are an important first step in reducing the regulatory burden on the financial advice industry, and should help in providing the flexibility to take advantage of future opportunities.

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[42] *Australia to 2050: future challenges*, the Treasury, 2010, available from: http://archive.treasury.gov.au/igr/igr2010/report/pdf/IGR_2010.pdf, p1.

[43] *Mid-year Economic and Fiscal Outlook 2013-14*, Commonwealth of Australia, December 2013, available from: http://budget.gov.au/2013-14/content/myefo/download/2013_14_MYEFO.pdf, p2.

Objectives of Government action

In its pre-election *Policy to Boost Productivity and Reduce Regulation*, the Coalition committed to amend FOFA to: "reduce compliance costs for small business financial advisers and consumers who access financial advice[44]". In particular, it indicated that it would: "implement all 16 recommendations made as part of the Parliamentary Joint Committee inquiry into FOFA[45]".

Since the election, the Assistant Treasurer has, in a number of speeches, re-affirmed the Government's commitment to: "reducing the regulatory overreach of FOFA[46]".

The objective of Government action is threefold:

1) Remove the unnecessary burdens imposed on the financial advice industry from FOFA measures that went beyond the recommendations of the Ripoll Inquiry;

2) Properly implement the finding of the Ripoll Inquiry so as to reduce regulatory overreach whilst maintaining the important consumer protection measures introduced by FOFA; and

3) Address other technical and consequential concerns raised by industry.

A summary of the key proposed changes is presented in table 2. These are detailed further in the "impact of changes" section later in this document.

Table 2: Summary of changes to FOFA

FOFA component	Concern	Change
Best interests duty	The best interests duty, as currently drafted, has created significant uncertainty amongst advisers. Many industry stakeholders have argued that this uncertainty is ongoing and needs to be addressed by regulatory change. These stakeholders argue that the open-ended nature of the duty leaves advisers uncertain on how to satisfy their duty. They also expressed concern that advisers are vulnerable to legal action because adviser's obligations under the duty is not well defined nor well understood.	Government action will remove the open-ended nature of the best interests duty. Whilst the Ripoll Inquiry recommended imposing a fiduciary duty on advisers, it did not recommend it to be an open-ended obligation.
Scaled advice	Scaled advice (a form of targeted advice that is limited in scope, and is typically much cheaper than full, holistic advice), was supposed to have been accommodated	Government action will facilitate the provision of scaled advice, whilst ensuring advice remains appropriate to the

[44] The Coalition's Policy to Boost Productivity and Reduce Regulation, July 2013, p26.
[45] The Coalition's Policy to Boost Productivity and Reduce Regulation, July 2013, p26.
[46] Assistant Treasurer, Keynote Address to the 2014 Insurance Council of Australia Regulatory Update Seminar, 28 February 2014, available from: http://axs.ministers.treasury.gov.au/speech/008-2014/.

FOFA component	Concern	Change
	by the best interests duty. However, many advisers have indicated that they are not confident that they can legally provide this form of advice. This uncertainty has resulted in advisers spending more time and money on activities than otherwise necessary, such as understanding their legal obligations and documenting compliance with the best interests duty.	client. This action will properly implement the policy intent of the Ripoll Inquiry.
Fee disclosure statements	Fee disclosure statements are currently required to be provided to all clients, including those in ongoing fee arrangements prior to the introduction of FOFA on 1 July 2013, and were designed to increase the engagement of clients and improve transparency in the industry. According to industry stakeholders, providing fee disclosure statements to pre-1 July 2013 clients is difficult and expensive: many of these clients are on old legacy systems, predating the FOFA changes; as such, significant manual work is required to prepare statements for these clients. By contrast, as post-1 July 2013 clients are on newer, FOFA compliant systems, it is—comparatively speaking—much cheaper and efficient to produce fee disclosure statements for these clients. In the exposure draft of the original FOFA legislation, fee disclosure statements were only intended for post-1 July 2013 clients.	Government action will remove the requirement for fee disclosure statements to pre-1 July 2013 clients, but keep the requirement for post-1 July 2013 clients. The requirement to provide fee disclosure statements was not a recommendation from the Ripoll Inquiry.
Opt-in provisions	The opt-in requirement was introduced to increase client engagement. However, many industry stakeholders have argued that the opt-in notices do not offer substantial benefits to consumers; particularly as consumers already have the ability to opt-out of their arrangements. Many stakeholders have also indicated that, whilst the opt-in provisions are trying to institute a behavioural shift in the way clients interact with advisers, the changes required are too great for the financial	Government action will remove the opt-in requirement. Opt-in was not a recommendation from the Ripoll Inquiry.

FOFA component	Concern	Change
	advice industry to bear alone; rather, any changes in consumer engagement should be part of a broader strategy.	

Options that may achieve the objectives

This regulation impact statement (RIS) assesses the impacts of the Government's proposed amendments based on its election commitment; it does not explore any other options (in accordance with the Office of Best Practice Regulation's (OBPR) guidelines).

Whilst the Government's election commitment was to implement the 16 recommendations of the Dissenting Report, a number of the recommendations are no longer applicable as changes have already been made to FOFA that achieve the objectives sought, or the recommendations are no longer relevant due to the passage of time.

As such, this RIS considers the impact of a package of amendments to FOFA, including all of the (still relevant) Dissenting Report recommendations, as well as some additional amendments to address industry concerns.

Impact analysis

Overview of impact on industry and consumers

The proposed amendments to FOFA seek to navigate the fine line between ensuring that unnecessary and burdensome regulations that drive up the cost of business are removed, whilst ensuring that the consumer protections of FOFA are maintained.

The proposed amendments to FOFA are deregulatory and will reduce the compliance burden on the financial advice industry. Feedback from consultations and submissions on the draft amendments varied, and ranged from a complete rejection that any changes need to be made to FOFA, through to wholesale support.

Many industry stakeholders indicated that the proposed amendments will result in a more practical framework for financial planners and their clients. These stakeholders have argued that the changes will: provide clarity to industry, more closely align FOFA with the intentions of the Ripoll Inquiry, and deliver significant cost savings that will ultimately benefit consumers.

Consumer groups—and some industry stakeholders—are far less enthused. Most of the submissions have argued that the proposed package of amendments go too far in winding back the consumer protections introduced by FOFA. In particular, some stakeholders expressed concern that a number of proposed amendments, including the changes to the best interests duty, the removal of opt-in provisions, and exempting general advice from the definition of conflicted remuneration, will leave consumers vulnerable to poor quality advice by reducing the standard of advice provided. Furthermore, it is suggested that the amendments could reduce the level of trust and confidence in the financial advice industry, all of which runs contrary to the recommendations of both FOFA—as introduced by the former Government—and the Ripoll Inquiry.

A more detailed analysis of the benefits and costs of each of the amendments is presented below.

Cost savings

Estimates

Treasury's estimates of the ongoing cost savings are approximately $190 million per year, with one-off implementation savings of approximately $90 million; these estimates represent just over half of the estimated $375 million ongoing costs of complying with FOFA[47]. A breakdown of the estimates is presented in Table 3.

Table 3: Breakdown of FOFA amendment savings estimates

Proposed change	Estimated average ongoing cost saving per year ($Million)*	Estimated implementation cost saving ($Million)*
Remove opt-in requirements	$45.1	$76.9
Limit the annual fee disclosure requirements to be for prospective clients only	$40.8	$0.8
Removal of the 'catch all' provision in the best interests duty	$33.3	Nil
Explicit provision of scaled advice	$34.1	Nil
Limit the banning of commissions on life (risk) insurance provided under superannuation	Nil	Nil
Exempt "general advice" from "conflicted remuneration" under certain circumstances	$36.3[48]	$10.0
Clarify the exemption from the ban for execution-only services	Nil	Nil
That the training exemption permits training expenses related to conducting a financial services business, rather than just the provision of advice	Nil	Nil
Amendments to volume-based shelf-space fees	Nil	Nil
Clarify the definition of intra-fund advice	Nil	Nil
Grandfather existing remuneration from the ban on conflicted remuneration	Nil	Nil
Explicitly recognise that a "balanced" remuneration structure is not conflicted remuneration	Nil	Nil
Allow bonuses to be paid in relation to revenue that is permissible under FOFA	Nil	Nil
Include consumer credit insurance in the basic banking carve-out	Nil	Nil
Amendments to the FOFA stockbroking exemptions	Nil	Nil
Other minor technical changes	Nil	Nil
Total	**$189.7**	**$87.7**

[47] Mr John Brogden, CEO of the Financial Services Council, during PJC hearings.

[48] The cost savings for this amendment differ from the savings published in the options-stage RIS as the general advice exemption has been modified (see detailed analysis for further explanation). It is estimated that the modifications will affect some of the firms in the small and medium firm segments but none of the large firms.

*These estimated cost savings refer only to direct cost savings.

Methodology

Given the size and disparity of the financial advice sector, and differences in operational aspects and cost structures within the industry, it is difficult to reliably estimate costs and cost savings. Notwithstanding this fact, the Australian Government's Business Cost Calculator was used to produce an estimate of the cost savings from the proposed amendments to FOFA (in accordance with OBPR guidelines)[49].

For the purposes of calculating the cost savings figures, the financial services industry was split into three segments based on firm size. Adviser groups with more than 1000 advisers were classified as "large" firms. All adviser groups with less than 60 advisers were classified as "small" firms, and the remaining adviser groups were deemed to be "medium" firms.

Industry data was obtained from all three industry segments through consultations with key industry bodies—these bodies in turn liaised with their membership base—and large industry participants. Industry participants were asked to provide accurate data indicating the cost savings for each of the amendments.

Firms were asked to identify their cost savings as either "labour cost savings", which are calculated by reference to the amount of time saved per firm multiplied by a cost of labour, or "purchase cost savings", which are purchases that the firm would no longer be required to make as a result of the amendments to FOFA. For each amendment, firms provided labour cost savings data on: the number of employees affected, if any; the amount of time that would be saved per employee; and the cost of labour for the affected employee(s). For purchase cost savings, firms provided an estimate of the cost savings that would arise under each of the proposed amendments.

A bottom-up approach was used to estimate industry savings. The inputs provided from each industry segment were averaged—on a per firm basis—then multiplied by the number of firms in the industry to generate a cost savings estimate for that segment. These segment estimates were added to arrive at a total industry cost savings estimate.

A detailed breakdown of the cost estimate inputs cannot be publicly released as some of the data was provided on an in-confidence basis. That said, a summary table of average inputs is provided in Table 4. As shown, the majority of cost savings are derived from labour cost savings, with relatively small savings from purchase costs.

As an example, the removal of the "catch-all" provision within the best interests duty is estimated to save $33.3 million per year. This calculation is based on an average labour cost per person of approximately $62 per hour, and an estimated average time saving of just over 14 hours per firm, per week.

The average labour cost varies across amendments due to the different wage rates of employees performing different functions. For example, the scaled advice provision has the highest labour cost because this amendment directly affects the time of financial advisers, who are typically on higher wage rates than other staff members in the organisation. By

[49] *Business Cost Calculator*, the Office of Best Practice Regulation in the Department of the Prime Minister and Cabinet, available from: https://bcc.obpr.gov.au/.

contrast, the opt-in amendment has the lowest labour cost because this function is able to be performed by staff on lower wages: mainly administrative or clerical staff.

The estimated cost savings, which were calculated using data provided by industry, are based on the assumptions and methodology set out above. It should be noted that industry cannot perfectly foresee the impact of the amendments on their cost structures; therefore, actual cost savings may differ from those estimated in this document: these figures are estimates only.

Table 4: Summary of cost savings inputs

FOFA amendment[50]	Number of hours per firm (per week)[51]	Average labour cost ($ per hour)[52]	Total labour cost savings ($M per year)[53]	Total purchase cost savings ($M per year)[54]	Total cost savings ($M per year)[55]
Fee disclosure statement requirements	20.0	$60.5	$46.1M	$0.3M	$46.4M
Removal of opt-in	18.4	$54.1	$37.9M	$2.3M	$40.2M
Removal of the catch all provision	14.2	$61.9	$33.3M	Nil	$33.3M
Explicit provision of scaled advice	14.3	$63.2	$34.1M	Nil	$34.1M
Exempt "general advice" from "conflicted remuneration" under certain circumstances	17.9	$59.5	$36.3M	Nil	$36.3M

Limitations

Whilst it is anticipated that some of the cost savings to industry will be passed through to consumers, it is difficult to quantify the extent to which this will occur. Cost savings could flow through to consumers either through a reduction in the cost of advice, or through the avoidance of (an otherwise necessary) price increase. It is anticipated that, in any case, the cost of advice under the proposed amendments will be lower than if the amendments were not implemented.

[50] The total cost savings figures for the fee disclosure statement and opt-in amendments differ from the cost savings estimates provided in Table 3 of the RIS. The figures presented in this table represent the savings achieved in the first year of the amendments, whereas the figures presented in Table 3 are average cost savings over ten years (presented as an average to comply with OBPR guidelines).

The savings from the fee disclosure amendment is expected to decrease over time whereas the saving in relation to the opt-in amendment is expected to increase over time.

Cost savings for the remaining three amendments are not expected to change over time, so are identical to the figures in Table 3.

[51] Number of hours per firm (per week) have been rounded to one decimal point.

[52] Average labour cost (per hour) have been rounded to one decimal point.

[53] Total labour cost savings have been rounded to the nearest $100,000.

[54] Total purchase cost savings have been rounded to the nearest $100,000.

[55] Total cost savings have been rounded to the nearest $100,000.

It is important to note that the Business Cost Calculator only calculates the ***direct*** cost savings of the proposed amendments, and does not consider indirect or "second-round" savings or opportunity cost savings. Whilst some of the amendments, such as those designed to provide clarity to industry, may not result in direct and quantifiable cost savings, second-round or indirect cost savings are likely to arise.

For example, if an adviser attends a training course to increase their understating of the best interests duty, the cost of that training course *would* be included in the Business Cost Calculator as it represents a direct cost related to compliance. By contrast, if the adviser were to forego giving advice for a few hours in order to research their best interests duty obligations (that is, at no external cost), the foregone revenue from the advice that could otherwise have been earned is *not* included as it is an opportunity cost.

Similarly, the cost savings to consumers is *not* included in the calculations, as it is a 'second-round' saving; the "first-round" saving occurs to firms. The impact of the amendments on consumers is discussed in more detail throughout this section.

Stakeholder feedback on estimates

Treasury's initial impact analysis and cost savings estimates were published in the options-stage RIS, and provided an opportunity for stakeholders to engage with the Government on the impact of the proposed changes. Stakeholders were also provided an opportunity to comment on the RIS during consultations on the draft amendments; these consultations were conducted during February 2014.

Key industry bodies broadly agreed with the qualitative impact analysis presented in the options-stage RIS. They reiterated their belief that the proposed amendments will reduce the regulatory burden on industry and increase the affordability of financial advice for consumers, whilst also ensuring appropriate protections are in place for investors. They consider that the amendments are necessary to provide certainty to all stakeholders and reduce the unnecessary complexity and burden that is inhibiting their ability to provide cost-effective advice to consumers.

Industry bodies also agreed with the quantitative analysis of the cost savings presented in the options-stage RIS. No key industry bodies or industry participants brought forward new data or amended their previously provided data for the details-stage RIS.

Whilst some industry stakeholders indicated that the published numbers appeared conservative, there was insufficient substantive new information to warrant increasing the cost savings estimates for the details-stage RIS.

Consumer groups did not raise any specific concerns with cost savings estimates calculated except to indicate that the cost savings to consumers should be considered in addition to the cost savings to industry.

As noted above, whilst this RIS quantifies the direct cost impacts to the industry, there are not expected to be any direct or "first-round" compliance cost impacts for consumers. Instead, a qualitative explanation of the costs to consumers will be provided in the measure-by-measure analysis below.

Following feedback from industry and consumer groups, no changes were made to the cost savings as calculated in the options-stage RIS. However, an adjustment has been made to the

cost saving estimate for the general advice exemption; this adjustment reflects the revised exemption (see detailed analysis below for further details).

Detailed analysis on Dissenting Report amendments

As mentioned above, feedback was received on the options-stage RIS as part of the consultations on the proposed FOFA amendments. The primary theme that emerged was that the options-stage discussion of the impacts of each of the proposed amendments was overly technical, and primarily focused on the benefits to industry; many stakeholders felt that the options-stage RIS contained insufficient consideration of the costs to consumers, or that the impact of some of the amendments on consumers was understated.

This details-stage RIS has attempted to address these concerns. For the purposes of this RIS, the proceeding section presents, for each of the proposed amendments: a technical description of the change; a description of the industry impacts; a description of the consumer impacts; a critical analysis of these impacts and conclusion as to the net impact for each amendment. Any conclusion as to the net impact of the proposed amendments is an "on balance" assessment.

Remove opt-in requirements

This amendment removes the requirement for advisers to obtain their client's approval, at least every two years, to continue an ongoing fee arrangement; the opt-in provisions only relate to clients who enter into an ongoing fee arrangement from 1 July 2013. Whilst FOFA became mandatory on 1 July 2013, the effective start date for opt-in is 1 July 2015 as clients only need to opt-in every two years.

The opt-in requirement was introduced to enable customers to assess the quality of service they receive for the fees they pay. Currently, if a client does not opt-in within 30 days of receiving an opt-in notice, their ongoing arrangement is terminated (termination occurs 60 days after receiving the opt-in notice). Under the proposed amendment, clients will no longer be required to opt-in, and will maintain their existing right to opt-out of their ongoing fee arrangements.

Industry stakeholders have been largely supportive of this proposed change, although the reasons have varied. Many stakeholders have cited the high implementation and ongoing costs of the opt-in system, which are likely to be passed through to the consumer, as a strong motivation for removing the requirement. These costs relate to implementing and maintaining systems, additional staff involvement, other administrative overheads, and are closely linked to the number of customers; as such, these costs are anticipated to increase over time as client numbers increase.

Other industry stakeholders have argued that firms in the financial services industry, particularly those who are members of a professional industry association, should be actively promoting client engagement independent of statutory requirements. The argument is that these firms should be engaging with their clients to earn their trust and prove their "value add". These stakeholders, therefore, argue that opt-in, of some form or another, is already occurring in many instances, and that the driver of this consumer engagement should come from industry rather than be mandated by government.

One final, albeit related, argument is that the opt-in provisions impose too high a standard on financial advisers. Whilst these stakeholders laud government attempts to improve consumer engagement, they argue that the provisions that apply to financial advisers are out-of-sync

with the rest of the financial services industry: nowhere else is an opt-in requirement mandated. As such, the argument is that the opt-in provisions should be removed and only reinstated as part of a much broader, systemic attempt to ensure greater consumer engagement.

Consumer groups have argued that opt-in is important to promote client engagement and transparency of fees charged. An ASIC report found that only 33 per cent of clients serviced by the top 20 licensees were considered active[56], which suggests that the majority of clients are inactive or disengaged. For such consumers, the opt-in requirement provides an opportunity to assess whether they wish to continue their arrangement(s) with their adviser, a decision that is aided by the fee disclosure statement—see discussion on fee disclosure statements below.

Client engagement is considered important in ensuring that clients actively monitor their financial position and are aware of any changes to their account(s). Consumer groups have argued that removing the opt-in requirement will drive up the cost of advice, as advisers will earn revenue from disengaged or "'passive" clients without providing any advice to them. It is argued that if these clients were more engaged, they would be in a better position to weigh up their options and consider switching into a lower cost (possibly fee-for-service) product.

Some stakeholders have argued that the opt-in requirements are necessary as FOFA has allowed ongoing percentage-based fees to continue to be charged: under FOFA, asset-based fees—which are calculated based on the value of the assets invested with the adviser—are able to be deducted from a client's account on a regular basis, and for an indefinite period of time, as long as the client initially consents to the charges. These stakeholders have argued that these asset-based fees have exactly the same effect as sales commissions, and that, with the removal of opt-in, there will be no mechanism to ensure that ongoing fees are only being charged where ongoing advice, or at least ongoing communication, is being received.

According to these stakeholders, removing the opt-in requirements will be at a heavy cost to consumers. One submission argued that a 0.5 per cent ongoing fee would equate to a $46,000 reduction in the super balance of an average superannuation member over their working life. Given that, according to these stakeholders, around two million super fund members were paying ongoing fees but were not receiving any financial advice, the removal of opt-in has far reaching consequences.

The consumer benefits of the opt-in requirements cannot be denied. The opt-in requirements were, and are, a paradigm shift in the battle to increase client engagement. By requiring advisers to seek client approval to continue arrangements, opt-in nudges clients into actively considering whether they are receiving service commensurate to the fees that they have paid and thereby raises the service levels of the industry.

That said, the opt-in requirement places a disproportionately large burden on financial advisers; a burden not replicated in other areas of, or even outside of, the financial services industry. Whilst there is no doubt that the removal of the opt-in requirement is likely to reduce client engagement, there are a range of other measures within the legislation that are intended to promote client engagement; for example: statements from superannuation trustees, product manufacturers, and fee disclosure statements will provide consumers with

[56] ASIC *Report 251*: *Review of financial advice industry practice*, 2011.

information on the fees and charges they are incurring. Furthermore, consumers will continue to be able to opt-out at any time.

The opt-in requirement was not recommended by the Ripoll Inquiry. The Dissenting Report comments:

> The Ripoll Inquiry, having comprehensively considered the state of Australian financial products and services back in 2009, made no recommendation to force Australians to re-sign contracts with their financial advisers on a regular basis[57].
>
> …
>
> There is no precedent for this sort of government red tape in the context of financial services and advice relationships anywhere in the world[58].

Notwithstanding the consumer benefits that arise from opt-in, the disproportionate treatment of financial advisers relative to the rest of the financial services industry, and the significant ongoing and implementation costs to achieve these measures, indicate that the cost savings to industry outweigh the consumer benefits from the removal of the opt-in provisions.

Limit the annual fee disclosure requirements to be for prospective clients only

This amendment removes the requirement for advisers to provide a fee disclosure statement to clients who entered into their advice arrangement prior to 1 July 2013. Advisers will still need to provide an annual fee disclosure statement to post-1 July 2013 clients. Fee disclosure statements provide customers with a single statement that shows, for the previous 12 months, the fees paid by the client, the services the client received, and the services the client was entitled to receive.

Industry has strongly supported the removal of the fee disclosure statement requirements for pre-1 July 2013 clients. Industry stakeholders have argued that it costs significantly more to produce a fee disclosure statement for a pre-1 July 2013 client than for a post-1 July 2013 client[59]. These stakeholders have indicated that these costs will be passed onto the client and will reduce the accessibility and affordability of financial advice. They have also argued that collecting the information for fee disclosure statements can be a convoluted process, as the information needs to flow from (often multiple) product manufacturers to licensees, and are then passed onto the relevant adviser(s) before the statement can be created and sent to the client. It is argued that this process can involve a significant investment of time and resources, especially for pre-1 July 2013 clients.

Consultations have suggested that the higher costs for old clients are primarily driven by the age of systems, which struggle to provide accurate fee information for pre-1 July 2013 clients. As a result, to ensure that fee disclosure statements to pre-1 July 2013 clients are accurate, a significant amount of adviser time is required to quality assure the disclosure statements. The annual cost saving for this proposed amendment is estimated to decrease over time as a greater portion of clients receive fee disclosure statements.

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[57] Dissenting Report, February 2012, p160-161.
[58] Dissenting Report, February 2012, p160-161.
[59] Dissenting Report, February 2012, p165.

Consumer groups have argued that the fee disclosure statement is an important source of information, particularly for consumers who may not have the time or skills to collate and fully understand the fees they are paying. It is argued that this amendment adversely affects pre-1 July 2013 clients, who may continue to be placed in ongoing, expensive fee arrangements—even if there are better alternatives available—as they will not have a simple source of information to prompt them to compare their arrangements to others. It is therefore argued that, due to information asymmetry, this amendment would affect the bargaining power of clients when negotiating fee arrangements with their adviser.

In the absence of fee disclosure statements, pre-1 July 2013 clients will be required to piece together the fee details from multiple statements, often with different cut-off dates, to calculate an annual fee; such an exercise would be beyond the capabilities of many advice clients. Whilst advisers may help their clients complete such a task, it would most likely be at a substantial cost to the client.

Notwithstanding the benefits to pre-1 July 2013 clients from receiving a single statement outlining the fees they have paid, most of these clients are currently paying conflicted remuneration (in the form of grandfathered commissions) to their advisers rather than a "fee for service" charge. Conflicted remuneration is not included in the fee disclosure statements, so there may be little additional information obtained by the statements for the pre-1 July 2013 clients. Both pre- and post-1 July 2013 clients will continue to receive other reports that identify the fees paid to an adviser; for example: superannuation and product statements. This, in conjunction with the other client engagement mechanisms, both in the legislation and through the professional conduct standards promoted through professional bodies, should ensure that clients remain engaged and are able to monitor and change their investments when necessary.

Fee disclosure statements were not included as part of the recommendations from the Ripoll Inquiry. The Dissenting Report comments:

> The Ripoll Inquiry made no recommendation to introduce an additional annual fee disclosure statement over and above the current regular statements provided by financial service product providers to their clients already[60].

In addition, when the requirement to provide fee disclosure statements was first announced, it was only intended to apply prospectively, that is, to post-1 July 2013 clients. The Dissenting Report comments:

> …the Committee received strong evidence that based on the various FOFA consultations sessions, it was the industry's clear understanding that the government's proposal to impose an additional annual fee disclosure statement would be prospective—that is, only apply to new and not existing clients[61].

The rationale was that any "new", post-1 July 2013 clients, would come under the FOFA compliant products and systems; these products and systems would be specifically designed to facilitate the provision of the fee disclosure statements.

[60] Dissenting Report, February 2012, p163.
[61] Dissenting Report, February 2012, p163.

However, and as indicated by many industry stakeholders, the retrospective application of fee disclosure statements appears overly onerous. When considered in conjunction with the questionable value of the fee disclosure statements for pre-1 July 2013 clients, which do not report conflicted remuneration, it would appear—on balance—that the cost savings to industry outweigh the consumer benefits.

Removal of the 'catch-all' provision in the best interests duty

This amendment removes paragraph 961B(2)(g), which is known as the "catch all" provision, from the best interests duty. Subsection 961B(1) imposes a requirement on advisers to act in the best interests of the client in relation to the advice provided. Subsection 961B(2) then provides a series of steps that an adviser can follow to prove that they have discharged their duty to their client. Paragraph 961B(2)(g) is the last of the steps and states that an adviser must prove that they have "taken any other step [in addition to the six preceding ones] that … would reasonably be regarded as being in the best interest of the client". The intention behind the catch all provision was to make the best interests duty flexible and principles-based, thereby avoiding legislation becoming overly prescriptive. Subsection 961B(2) is often called a "safe harbour" as it provides protection for advisers looking for certainty in satisfying their duty.

The proposed removal of paragraph (g) has been supported by industry, which has expressed concerns that the current provision is unclear due to its open-ended nature and has created significant legal uncertainty on how advisers can actually satisfy the best interests duty. Industry has noted that the current drafting of the best interests duty has led to advisers spending more time than otherwise necessary documenting the advice they have provided to their clients to demonstrate compliance with the best interests duty. As such, industry stakeholders claim that the catch all provision renders the safe harbour protection of subsection 961B(2) unworkable. They believe that removing paragraph 961B(2)(g) will ensure that section 961B(2) functions as a true safe harbour, as the remaining six steps are more objective.

By contrast, some stakeholders have likened removing paragraph (g) to a repeal of the best interests duty. Consumer groups have argued that the catch all provision is the most important part of the best interests duty, as it makes the duty flexible and principles-based. They argue that removing the catch all provision could lead to consumers receiving lower quality advice as it weakens the best interests duty by reducing it to a "tick-a-box" exercise for advisers. Consumer groups have argued that, under a modified best interests duty, an adviser could satisfy the remaining six steps of the best interests duty but still not provide advice that is in the best interests of their client.

Some stakeholders have also raised concerns that this amendment, which they argue is likely to lead to an increase in the prevalence of poor advice, will result in an increased risk of financial scandals resulting in consumer losses.

At the time the original FOFA legislation was being drafted, many stakeholders indicated that, in introducing a best interests duty, only subsection 961B(1) was required. However, concerns were expressed that, without any additional guidance, subsection 961B(1) alone would cause confusion, and it would be left to the courts to provide guidance on how advisers could satisfy their best interests duty.

In response to this uncertainty, subsection 961B(2) was inserted. This subsection was never intended to be a safe harbour; rather, it was included to provide the guidance advisers were

seeking on how they could satisfy their best interests duty. Because this subsection was not intended to be an exhaustive list, paragraph (g) was inserted to ensure the subsection remained flexible. However, over time, perception of this provision has changed, and it is now commonly accepted to be a safe harbour; even ASIC, in its regulatory guides, refers to subsection 961B(2) as a safe harbour[62].

The proposal to remove the catch-all provision is intended to properly implement the recommendations from the Ripoll Inquiry. The original Ripoll recommendation was to include a fiduciary duty for financial advisers to place their client's interests ahead of their own; there was no requirement that this duty be open ended. As such, subsection 961B(2) without paragraph (g) achieves this aim. The Dissenting Report comments:

> The best interests duty is an important and central part of the FOFA changes. Coalition Committee members support the introduction of a statutory best interests duty for financial advisers into the Corporations Act[63].
>
> …
>
> However, we are concerned that the "catch all" provision contained in section 961B(2)(g) would create uncertainty for both clients and their advisers and leave the legislation subject to potentially protracted legal arguments. We therefore recommend that this clause be removed[64].

Whilst a best interests duty without paragraph (g) will lower the standard required of advisers, the concerns expressed by consumer groups appears to be disproportionate to the change. The remaining steps in subsection 961B(2) still set a high standard, it just does not require an unending set of actions. When considered in conjunction with other measures—the requirement that advice be appropriate for the client, that advisers must place their client's interests ahead of their own, and the duty to warn clients if information is based on incomplete or inaccurate information—the amended best interests duty will still ensure that clients continue to receive advice that is in their best interests.

As such, the cost savings to industry appear to outweigh the consumer impacts.

Explicit provision of scaled advice

This amendment allows clients and advisers to explicitly agree on the scope of any scaled advice provided, whilst still ensuring the advice is appropriate for the client.

Whilst scaled advice is not specifically defined in the Corporations Act, it is usually referred to in the industry as a targeted form of personal advice; personal advice is advice that considers the financial objectives, situation, and needs of a person. All personal advice is "scaled" or "limited in scope" to some extent: advice is either less or more comprehensive in scope along a continuous spectrum. For example, scaled advice may cover a specific area of a client's needs such as insurance or superannuation, and can be contrasted to holistic advice that usually considers all of the client's financial needs.

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[62] ASIC *Regulatory Guide 175: Licensing: Financial product advisers-conduct and disclosure, October 2013, available from: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg175-published-3-October-2013.pdf/$file/rg175-published-3-October-2013.pdf, RG 175.238-175.249.*

[63] Dissenting Report, February 2012, p166.

[64] Dissenting Report, February 2012, p168.

The limited scope of scaled advice usually makes it much cheaper than more fulsome personal advice. This is due to the fact that an adviser needs to consider fewer of the client's circumstances, needs and objectives to provide the advice. As holistic personal advice can often be expensive, scaled advice is an affordable avenue for many consumers seeking personal advice.

This amendment has been welcomed by industry, which has argued that the best interests duty does not give them confidence that scaled advice can be provided. This uncertainty has led to advisers performing more work than necessary to ensure compliance with the best interests duty. In particular, it has resulted in advisers considering all of their client's circumstances when providing scaled advice, rather than only considering their relevant circumstances; this has had the effect of making scaled advice more expensive than otherwise necessary. Industry has indicated that advisers, in some instances, have not been providing scaled advice at all.

Consumer groups have raised concerns that this amendment could allow advisers to avoid certain obligations imposed by the best interests duty thereby affecting the quality of advice provided to consumers. These stakeholders are particularly concerned that customers could be left vulnerable to poor quality advice, as the amendment could allow an adviser to agree a scope of the advice that may not be in the best interests of their client. This concern is particularly salient for clients who: have low levels of financial literacy, place a great deal of trust in the knowledge and experience of an adviser, and are likely to agree to suggestions from an adviser on the scope of the advice they are to receive without appreciating the implications of what they have agreed to.

For example, a client may go to an adviser seeking information about their finances. Due to the prohibitive cost of a holistic financial plan, a client may agree—perhaps at the advisers suggestion—to limit the scope of the advice to a particular area, and only consider the products offered by the adviser's employer.

The concern some stakeholders have with the example above is that the client may need urgent advice on one particular area, but may not actually receive this advice as it has been scoped out. If the client is not told about this other advice area, then the client may not fully appreciate that they are missing out on advice that may be better for them. Furthermore, by limiting the advice to products offered by the adviser's employer, the client may not be informed about alternate investments that may actually be more suitable for their particular circumstances.

Concerns have also been expressed that this amendment could reduce the number of products offered in the industry, as advisers become incentivised to offer scaled advice on more costly, and hence lucrative, financial products.

As with the changes to the best interests duty, the proposal to allow clients and advisers to explicitly agree on the scope of scaled advice is intended to properly implement the recommendations from the Ripoll Inquiry, and is closely linked to change to the best interests duty. The Dissenting Report comments:

> One way of ensuring that clients are able to access affordable and appropriate financial advice would be to allow advisers and their clients to limit the scope of the advice to a series of discreet areas identified by the client rather than to mandate a full financial plan in every case.

> This concept of focusing advice to areas specifically identified by a client has become widely known as "scalable advice".
>
> Numerous submissions to the Committee expressed concern that the wording of the best interests provisions in the proposed legislation does not allow for scaled advice to be provided[65].

There is some debate within industry as to whether the current legislation actually permits scaled advice to be provided. Whilst there is currently no explicit provision that allows the client and adviser to agree a scope of advice, a number of advisers are already providing scaled advice and have not incurred the problems expressed by industry stakeholders. As such, whilst the concerns raised about advisers inappropriately agreeing a scope of advice is possible under the proposed amendment, it may already be possible under the current arrangements.

It is doubtful whether the dire outcomes indicated by consumer groups will eventuate. The FOFA provisions relating to the appropriateness of advice, and requiring an adviser to place their client's interests ahead of their own, will ensure that, even if the adviser agrees a scope that is inappropriate to the client, they will not be able to provide advice that is inappropriate.

As such, the cost savings to industry outweigh the consumer benefits.

Commissions on life (risk) insurance provided within superannuation

The Government originally proposed amendments to expand the range of circumstances under which commissions may be paid on life (risk) insurance products provided within superannuation to include circumstances where personal advice has been provided on these products.

Through consultation on the proposed amendments and broader industry engagement, the Government has become aware that, whilst the life insurance industry as a whole remains well capitalised and profitable, in relation to certain business lines there are grounds for concern regarding the long term sustainability of some current industry practices, including in relation to remuneration.

In light of these concerns, the Government intends to undertake a separate process to engage with the life insurance industry on these issues. In order to ensure that the industry's regulatory environment is not subject to further change while this process is underway, the Government does not propose to progress amendments to the treatment of life (risk) insurance at this time.

Exempt 'general advice' from 'conflicted remuneration'

This amendment exempts general advice from conflicted remuneration under certain circumstances. Currently, the conflicted remuneration provisions capture both general and personal advice; conflicted remuneration cannot be paid on either type of advice. This amendment will allow conflicted remuneration to be paid on general advice under certain circumstances; conflicted remuneration on personal advice will continue to be banned.

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[65] Dissenting Report, February 2012, p168.

The Government originally proposed to exempt all general advice from the definition of conflicted remuneration. This approach was outlined in the options-stage RIS published by the OBPR in January 2014. Feedback on this proposal was received as part of consultation on the draft amendments.

Many industry stakeholders support the originally proposed amendment as they believe the current ban on conflicted remuneration captures activities that were not the primary focus of FOFA—the ban currently captures employees such as website designers or general information seminar providers who are not in product sales related areas. Industry argue that they are currently required to maintain complex systems when providing general advice to ensure compliance with the existing conflicted remuneration provisions. These systems are costly to implement and maintain.

Industry stakeholders have also argued that allowing benefits to be paid on general advice will ensure the provision of more general advice. These stakeholders believe this is a positive outcome for society as general advice often serves to inform and educate, and is a way for consumers to receive financial advice they might otherwise not have access to.

By contrast, consumer groups believe that exempting general advice from the definition of conflicted remuneration may have a significant negative impact on consumers, and the financial advice industry as a whole.

These stakeholders agree that excluding general advice from the definition of conflicted remuneration will ensure the provision of more general advice. However, they suggest that it will also result in the industry moving towards general advice models, and may lead to an overprovision of general advice relative to personal advice as advisers would be incentivised to earn conflicted remuneration through general advice based sales.

These stakeholders argue that there is a significant consumer detriment involved as many consumers do not understand the distinction between personal and general advice. As a result, they may make financial decisions that are not appropriate for them if they mistakenly rely and act on general advice thinking it to be personal advice.

Stakeholders also argue that the amendments may adversely affect the reputation of the industry by effectively allowing commissions to be re-introduced and could lead to doubt in the minds of consumers as to whether the advice they have received—whether personal or general—is conflicted.

General advice is one of two forms of financial product advice; the other is personal advice. Financial product advice is defined as a: "recommendation or opinion that *influences* a person into making a decision on a financial product[66]" (emphasis added). Whilst general advice, unlike personal advice, does not consider the financial objectives, situation and needs of a person, it still influences a person's decisions. It was for this reason that both general and personal advice were included in the ban of conflicted remuneration.

The argument that general advice is provided to inform and educate, rather than to persuade and influence, is problematic for two reasons. Firstly, as defined, general advice does influence (or could reasonably be expected to influence) a person's choice. If the advice were truly factual, and couldn't reasonably influence a person's choice, then it wouldn't be

[66] Section 766B of the *Corporations Act 2001* (Cth).

financial product advice and thus payments in relation to it would not be conflicted remuneration. However, all general advice, no matter how informative, is—at some level—designed to influence a decision, usually to acquire a product or service from the provider of the general advice; if not, there would be no incentive for the provision of the general advice.

Secondly, there are many instances where general advice, and only general advice, is used to market and influence sales. Evidence suggests that complex products, such as exchange-traded options strategies—which have high returns but also high risks—are exclusively sold through general advice channels.

Further, general advice is often misunderstood and confused with personal advice. Whilst general advice does not consider the personal circumstances of the client, and whilst a general advice warning is required to be provided—which states that the advice given does not consider the personal circumstances of the client—many people ignore the warning and mistake general advice for personal advice. This is particularly the case where face-to-face contact is involved. A person attending a seminar who speaks to the presenter and tells them about their financial position could easily be confused into thinking that any answer to questions may have taken into account the personal circumstances disclosed when it has not.

In response to consumer and stakeholder concerns that the original amendment was too broad, the government has decided to restrict the operation of the carve-out. The revised general advice exemption will exempt benefits from the definition of conflicted remuneration if the following conditions are satisfied:

(a) general advice is provided by an employee;

(b) the employee has not given personal advice to the person receiving the general advice in the past 12 months; and

(c) general advice is in relation to a product issued or sold by the employer.

The imposed conditions will restrict the general advice exemption to employees who have not provided personal advice to the person receiving the general advice in the past 12 months.

This amendment alleviates the unintended consequences of the original general advice ban without providing too broad an exemption. Website designers, people giving seminars, and other employees who are involved in the preparation of general advice, but who do not provide personal advice, will now be able to utilise the general advice exemption. However, advisers who provide personal advice as well as general advice will *not* be able to utilise the exemption. As such, this amendment removes the unintended consequences whilst still allowing consumers who receive personal advice to remain confident that their advice is in no way influenced by conflicted remuneration.

Further, this amendment discourages a move into a general advice model. Given that the exemption does not apply if both general and personal advice has been provided, and given the significant upfront and ongoing training costs advisers incur to skill themselves to provide personal advice, it is unlikely that advisers who currently provide personal advice would move to a general-advice-only model.

To address concerns over sales of complex products, the Government has asked ASIC to monitor the use of the conflicted remuneration provisions as they relate to general advice on complex products. ASIC will provide a report to the Government in the next 12-18 months.

The revised general advice exemption is more restricted than originally proposed; accordingly, the consumer impacts are reduced, although not entirely mitigated. Given the narrower application of the exemption, and given the ongoing monitoring of the use of the provisions in relation to complex products, it would appear—on balance—that the cost savings to industry outweigh the consumer impacts.

A note on the cost impacts: consultations with stakeholders indicate that the restrictions on the general advice exemption will affect some of the firms in the small and medium segments but none of the large firms. Estimates of the extent to which the small and medium segments would be affected varied; as such, a conservative approach has been adopted when calculating the adjustment to the cost savings.

The restrictions in the exemption means that, where employees provide general advice only, separate systems no longer need to be maintained to ensure compliance with the conflicted remuneration provisions. As large firms separate advice streams — that is, employees who provide personal advice do not concurrently provide general advice — these large firms will be able to realise all of the cost savings estimated from the originally proposed amendments.

Whilst many of the small and medium firms have, similarly, separated their advice streams, not all of these firms have done so. Consequently, some of these firms will not qualify for the general advice exemption with the new restrictions. As such, these firms will be required to maintain systems to ensure compliance with the ban on general advice; these firms have been excluded from the cost savings estimates. The cost savings estimates in Table 3 have been updated accordingly.

The restriction on the general advice exemption has resulted in a reduction in the ongoing cost savings estimates of approximately $1.6 million per year; the consumer protections achieved by the restrictions are, therefore, large relative to the reduction in cost savings. The design of the restrictions, which addresses the unintended consequences created by the current conflicted remuneration provisions but avoids the pitfalls from providing too broad an exemption, means that most businesses do not need to incur additional compliance costs. As such, the consumer consequences of the original proposal can be minimised at negligible incremental cost to business.

Clarify the exemption from the ban for execution-only services

This amendment broadens the existing execution-only exemption from conflicted remuneration. The current exemption permits conflicted remuneration on execution-only services where no advice has been provided to a client by a licensee, or representative of that licensee, in the previous 12 months. This amendment will permit conflicted remuneration if no advice has been provided by the individual receiving the benefit for the execution service (as opposed to the licensee or representative employing the individual). Linking the provision of advice to an individual rather than a licensee or representative (usually a group entity) provides a more direct link between the provision of advice and the execution service.

Industry has supported this amendment as it enables benefits to be earned on legitimate execution-only services. Industry groups have argued that the drafting of the provision makes it complex and difficult and costly to comply with. They believe that execution-only

transactions are not accompanied by any advice, and hence are typically at the request of the client. As such, they believe that there are benefits associated with allowing conflicted remuneration on these transactions. This amendment provides clarity to advisers; the current legislation has had the unintended consequence of rendering advisers unable to receive conflicted remuneration despite there being no conflict of interest.

Some stakeholders have expressed concerns that financial advice firms will be able to give advice in one part of the business, and then execute the transaction in another part of the business so that conflicted remuneration can be earned. They have argued that this would result in extra charges for clients, whose investment returns would suffer as a result.

This situation is unlikely to occur given the anti-avoidance provisions within the *Corporations Act 2001*, which prohibit firms from restructuring their business models purely to circumvent the application of certain parts of the legislation. As such, the benefits to industry outweigh the consumer impact.

Training exemption

This amendment broadens the training exemption in relation to non-monetary benefits to cover all training relevant to conducting a financial services business. Currently, the exemption states that only training relevant to the provision of financial product advice is excluded from conflicted remuneration.

Industry has supported this amendment, as it allows them to use the training exemption for a wider range of activities, including administrative, dealing or trading activities. It is argued that the amendment will assist businesses in improving their productivity, and should raise the standard of advice being provided to consumers.

This amendment is not expected to have any material impact on consumers.

Amendments to volume-based shelf-space fees

This amendment clarifies the drafting of the ban on volume-based shelf-space fees to clearly define the benefits the ban intends to capture. In particular, it clarifies that incentive payments between fund managers and platform operators to give preferential treatment to certain products on the platform “shelf”—which could potentially influence advice provided to the client—are prohibited.

Industry has supported this amendment. They have argued that the current drafting of the legislation has unintended consequences that adversely affect firms in the industry, and that the amendment would clarify the operation of the law.

Consumer groups have argued that this amendment could result in advisers being influenced in their provision of advice. For example, advisers could place their clients in more costly products in order to earn a volume-based bonus through the platform. They believe that this would reduce the quality of advice provided to consumers and also be detrimental to their investment returns, as the volume-based fees are “built in” to the cost of their financial product(s).

This amendment simply clarifies the benefits the ban intends to capture. It does not change the existing law, other than to make it clearer to understand. As such, this amendment is not expected to have any material impact on consumers.

Clarify the definition of intra-fund advice

Intra-fund advice is defined in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) but is not specifically mentioned in FOFA. This amendment cross-references the definition of intra-fund advice from the SIS Act in the FOFA legislation. Intra-fund advice is a type of scaled advice provided by both retail and industry superannuation funds to their members. The advice is simple in nature and solely related to the member's superannuation products.

This amendment clarifies the operation of the law and does not have any direct impact on consumers.

Other changes

Grandfathering existing remuneration from the ban on conflicted remuneration

This amendment broadens the circumstances under which conflicted remuneration can continue to be paid (that is, grandfathered). As long as a client maintains their interest in a financial product, the proposed amendment will allow advisers to move licensees and continue to access grandfathered benefits; currently, any move after 1 July 2013 causes grandfathering to cease.

Industry has supported this amendment. It is argued that the amendment promotes greater competition between licensees and allows advisers to move between firms more freely. Most industry stakeholders argue that the current grandfathering provisions have reduced adviser movements in the industry and have effectively "frozen" the market; few advisers are willing to move licensees at all due to the loss of grandfathered benefits. Whilst the amendments allows grandfathered benefits to continue for a longer period of time, it is anticipated that industry will transition to a fee-for-service model as advisers cannot receive conflicted remuneration on arrangements entered into with new clients, and existing clients are likely to be transferred into new products/arrangements over time.

Some stakeholders are concerned that the grandfathering provisions will lock clients indefinitely into products that pay conflicted remuneration. They say that advisers will have no incentive to move their clients out of these products, because they would lose their benefit payments if they did so. These stakeholders believe that these clients will be adversely affected as conflicted benefits erode their investment returns over time, whereas these clients would have the opportunity to consider better alternatives if the grandfathering arrangements were not in place.

Despite these concerns, advisers will still be bound by the best interests duty, which will force them to consider whether their client's investment options are best suited to their financial needs, objectives and circumstances. The amendments to grandfathering will help the industry transition to a fee-for-service model and relieve the problems associated with the labour market 'freeze' which is currently discouraging advisers from moving between licensees.

There are also technical amendments to clarify that:

- when a financial planning business or client book is sold, the rights to the grandfathered benefits can be transferred to the purchaser, who will then receive the ongoing benefit;

- when an employed adviser becomes a self-employed authorised representative within the same licensing group, the adviser can continue to receive grandfathered benefits; and
- when a client switches from a superannuation product to a pension product, and both are offered under a multi-product offering, grandfathering will not cease in relation to that client's investment.

These minor technical amendments provide certainty and clarity to industry.

Explicitly recognise that a "balanced" remuneration structure is not conflicted

This amendment clarifies that benefits paid under a "balanced scorecard" arrangement are not conflicted remuneration. Balanced scorecard benefits are calculated by reference to both volume-based and non-volume-based factors. When FOFA was introduced, it was envisaged that payments made under a balanced scorecard approach would be able to rebut the presumption that volume-based benefits were conflicted.

Some industry groups have supported this amendment as it provides certainty for employers when paying bonuses under these arrangements. They argue that allowing a 'low' benefit to be paid to employees is consistent with the intent of the legislation, as it will not influence advice in a way which is detrimental to consumers.

Some consumer groups do not support this arrangement, as they believe that the bonus payments will influence the advice provided by advisers. It has also been argued that this amendment will favour larger firms, providing an incentive for employees to work for large firms, and that this will drive further consolidation in the industry.

This amendment clarifies that benefits that are already being paid—benefits that are currently allowed under FOFA—are permitted. As such, this amendment is not expected to have any material impacts on consumers.

Include consumer credit insurance in the basic banking carve-out

This amendment broadens the existing basic banking exemption to include consumer credit insurance. The exemption covers front-line bank employees who typically provide advice on basic banking and general insurance products; these employees were not the target of FOFA.

Consumer groups believe there to be a risk that conflicted basic products will be packaged with exempt products in a way that maximises the benefits being paid to the adviser.

This minor amendment clarifies the operation of FOFA. Consumers generally understand that these are basic financial products, so this amendment is not expected to have a material impact on consumers.

Allow bonuses to be paid in relation to revenue that is permissible under FOFA

This amendment permits payment of performance bonuses that are calculated by reference to remuneration that is exempt from the ban on conflicted remuneration. For example, an employer will be allowed to pay an adviser a bonus calculated by reference to the fee-for-service revenue the adviser generates in a given period. Currently, such a bonus may be banned as it is volume-based, even though the fee-for-service revenue it is based upon is not banned.

Industry has supported this amendment. It is argued that this amendment will assist industry in shifting to a fee-for-service model—one of the objectives of FOFA—and removes an inconsistency between earning permissible revenue and receiving a bonus on permissible revenue.

Consumer groups have argued that any bonus payments paid in relation to permissible revenue would like to influence the advice provided by advisers.

Whilst there is a likelihood that prices may rise as a result of bonus payments, the fact that this amendment will assist industry in shifting to a fee for service model outweighs any consumer concerns.

Amendments to the FOFA stockbroking exemptions

This amendment clarifies the existing stockbroking-related carve-outs under FOFA, including providing for the application of the brokerage fee exemption to products traded on the ASX24 (the ASX24 is a 24-hour platform for derivatives trading run by the ASX) and the broadening of the stamping fee exemption for initial public offering (IPO) arrangements.

These amendments are minor and clarify the operation of the legislation – stockbroking was not the intended target of FOFA and stockbroking-related activities have been largely carved-out of the reforms.

Consumers will not be materially impacted by this change.

Other minor technical amendments

The other minor amendments are:

- amendments to ensure that the wholesale and retail client distinction that currently exists in other parts of the Act also applies to the FOFA provisions; and

- amendments to clarify that the client-pays exemption operates to allow clients to direct product issuers—such as superannuation trustees or responsible entities of managed investment schemes—to deduct payments from the client's funds, or funds the client is beneficially entitled to.

These proposed changes are purely consequential and provide clarity to the operation of the law.

Specific impact on small businesses

As a result of these deregulatory amendments, small businesses are likely to be able to spend more time on their core business of providing financial advice to consumers and less time on compliance-related activities. This should result in both cost savings and revenue growth opportunities, both of which should increase the competitiveness of small businesses in the industry.

As noted earlier, the market is broken into small, medium and large firms. Small businesses, for the purposes of this analysis, are considered to employ fewer than 60 advisers. For the smallest firms, compliance requirements typically come with significant opportunity costs: small businesses have fewer staff available to dedicate to administration and compliance, and any time spent on compliance is time not spent providing advice, and hence earning fees.

Impact on Government

The impact on Government will be relatively small and non-ongoing. In the short-term, implementation costs will be incurred to draft the legislation for the proposed amendments, and to make changes to the regulations. ASIC's role as the industry regulator will continue, albeit under the new rules and regulations.

Consultation

Since the Ripoll Inquiry was initially commissioned in February 2009, extensive consultation has occurred with key stakeholders through submissions, consultation groups, public information sessions, consultation papers and meetings with stakeholders. Further consultations occurred in 2012 when the FOFA Bills were referred to the Parliamentary Joint Committee for Corporations and Financial Services (PJC) for inquiry and report.

In developing the proposed package of amendments, the Government conducted targeted consultations with a number of stakeholders, including the Association of Financial Advisers, the Association of Independently Owned Financial Professionals, the Australian Bankers' Association, Choice, the Financial Planning Association, Financial Services Council, Industry Super Australia, the Property Council of Australia and the major wealth management companies.

On 29 January 2014, the Government released, for a three-week consultation period, draft regulations and legislation to enact its proposed reforms to FOFA. Around 50 submissions were received as part of this process, from a range of stakeholders including industry associations, consumer groups, financial planning practices, consultants and individuals. A wide range of views were expressed in the submissions, which provided comment on the amendments, the options-stage RIS and other related issues outside the scope of the amendments. For the large industry associations and consumer groups, submissions were consistent with previously expressed views. The submissions also yielded a number of technical suggestions to ensure that the legislation and regulations achieve the desired policy outcome.

Treasury also conducted additional stakeholder consultations as part of the consultation period on the draft amendments. Many of the concerns and comments canvassed throughout the consultation period have been considered and incorporated into the final amendments. In particular, this consultation drove the decision not to proceed with the proposed amendments to commissions for life (risk) insurance and the changes to the exemption for general advice from the definition of conflicted remuneration. The information received through these consultations has also been considered in the preparation of this document.

With regard to the options-stage RIS, Treasury has fully complied with the RIS requirements.

Conclusion

The proposed amendments to FOFA are deregulatory and are anticipated to result in savings of approximately $90 million in implementation costs and an average of approximately $190 million in ongoing costs per year. These savings are expected to flow through to consumers and increase the affordability of financial advice.

As discussed in this document, there are risks involved with these amendments. In particular, some stakeholders consider that the amendments compromise consumer protections, and will undermine the goals of FOFA. The Government, however, is committed to maintaining the important consumer protections introduced by FOFA, and

these amendments reflect that commitment. The amendments will result in substantial cost savings and increased certainty for industry whilst maintaining the high standards expected by financial advisers, so that consumers of financial products and services remain protected against poor quality advice. On balance, the amendments will be beneficial for stakeholders of the financial services industry and promote the facilitation of high quality and affordable financial advice.

Implementation and review

The package of amendments will be implemented through legislation as well as regulations. To ensure the amendments are processed as soon as practicable, interim regulations will be made where legally possible; these interim regulations will be subsequently amended through legislation, and will be repealed once the legislative amendments have been passed. Those amendments best addressed through regulations will remain in place.

The Government anticipates that the legislation will be introduced into Parliament in the 2014 autumn sitting period, for passage in the winter sitting period.

Regulations are anticipated to be made by the end of March 2014. As with all regulations, there is a risk that the regulations will be disallowed. If this were to occur, the law would revert to the existing requirements and may cause regulatory uncertainty for industry.

A post-implementation review will commence within five years of these amendments being implemented.

Appendix A: Regulatory Burden and Cost Offset Estimate Table

Average Annual Change in Compliance Costs (from BAU)				
Sector/Cost Categories	Business	Not-for-profit	Individuals	Total by cost category
Administrative Costs	($198,442,592.58)[67]	$0	$0	($198,442,592.58)
Substantive Compliance Costs	$0	$0	$0	$0
Delay Costs	$0	$0	$0	$0
Total by Sector	($198,442,592.58)	$0	$0	($198,442,592.58)
Annual Cost Offset				
	Agency	Within portfolio	Outside portfolio	Total
Business	$0	$0	$0	$0
Not-for-profit	$0	$0	$0	$0
Individuals	$0	$0	$0	$0
Total	$0	$0	$0	$0
Proposal is cost neutral? No Proposal is deregulatory Yes **Balance of cost offsets = ($198,442,592.58)**				

[67] In accordance with OBPR methodology, this figure includes both the average annual ongoing cost savings (of $189.7m) as well as the one-off implementation cost savings (of $87.7m). For this purpose, the implementation costs savings have been annualised over a ten year period. As such, the $198.4m reported in this table is the sum of $189.7m (average ongoing cost savings) and $8.8m (annualised one-off implementation cost savings).

Attachment D

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011.*

Overview of the Legislative Instrument

The *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* (the Regulation) makes a number of amendments to the *Corporations Regulations 2001*. The amendments relate to the Future of Financial Advice (FOFA) provisions in Part 7.7A of the *Corporations Act 2001*:

- removing the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement), from when the Regulation commences until 31 December 2015;
- removing the requirement to provide an annual fee disclosure statement to clients in ongoing fee arrangements prior to 1 July 2013, from when the Regulation commences until 31 December 2015;
- removing the 'catch-all' provision from the list of steps an advice provider may take to satisfy the best interests obligation, and facilitating scaled advice, from when the Regulation commences until 31 December 2015;
- clarifying the treatment of ‘intra-fund advice’; and
- amending the application of the ban on conflicted remuneration including:
  - exempting general advice, subject to certain conditions;
  - amending the exemption for execution-only services to provide that only advice provided by the party receiving the benefit is considered;
  - clarifying the application of the existing client-pays exemption;
  - broadening the exemption for training and education that relates to operating a financial services business; and
  - broadening the existing exemption for basic banking products to allow an agent or employee of an authorised deposit-taking institution to access the exemption in a broader range of circumstances.

- broadening the circumstances when the grandfathering arrangements for the ban on conflicted remuneration apply;
- clarifying what benefits can be paid under a balanced scorecard arrangement;
- exempting bonuses paid in relation to 'permissible revenue';
- clarifying the application of the stamping fee exemption to capital raising activities and broadening its application to include investment entities;
- amending the application of the existing brokerage fee exemptions to include brokerage fees paid in relation to financial products traded on the ASX24; and
- ensuring that the wholesale and retail client distinction that currently applies in other parts of the Act also applies in respect of the FOFA provisions.
- clarifying the operation of the ‘mixed benefits’ provisions.

The Regulation also makes interim changes until the *Corporations Amendment (Streamlining of Future of Advice) Bill 2014* passes the Australian Parliament and receives the Royal Assent.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.