



Office of the Hon Chris Bowen MP

**Minister for Human Services
Minister for Financial Services, Superannuation
and Corporate Law**

THE FUTURE OF FINANCIAL ADVICE

**INFORMATION PACK
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Message from the Minister

The Government recognises the important role played by financial advisers¹ in assisting people to plan for their future. Longer term challenges such as the ageing of the population, as well as recent events such as the global financial crisis, underscore the need for quality advice.

It gives me great pleasure to announce significant reforms to the provision of financial advice, which I believe will improve the quality of advice, strengthen investor protection and underpin trust and confidence in the financial planning industry. These reforms should ultimately encourage more people to seek financial advice.

This package represents a comprehensive Government response to the recent Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services (the PJC Inquiry, see Attachment A), which was set up in the wake of collapses such as Storm Financial and Opes Prime.

In this respect, the Government's response is guided by two overriding principles:

- financial advice must be in the client's best interests – distortions to remuneration, which misalign the best interests of the client and the adviser, should be minimised; and
- in minimising these distortions, financial advice should not be put out of reach of those who would benefit from it.

The *Future of Financial Advice* contains three key reforms, which will apply from 1 July 2012:

- A prospective ban on conflicted remuneration structures, including commissions and any form of volume based payment. In addition, percentage-based fees (known as assets under management fees) can only be charged on ungeared products or investment amounts.
- The introduction of a statutory fiduciary duty for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients.
- The introduction of adviser charging regime, which retains a range of flexible options for which consumers can pay for advice and includes a requirement for retail clients to agree to the fees and to annually renew (by opting in) to an adviser's continued services.

The reforms also significantly expand the provision of low-cost simple advice (known as intra-fund advice) to areas including transition to retirement and the nomination of beneficiaries. There will be a review of whether other measures are needed to clarify whether simple advice can be provided in a compliant matter outside intra-fund advice.

I welcome the significant efforts of industry, including the Investment and Financial Services Association (IFSA) and the Financial Planning Association (FPA) to remove commissions. The reforms clearly support their efforts by introducing enhanced standards that apply across the retail financial services industry. The reforms will greatly reduce the incidence of investors being recommended financial products as a result of sales incentives offered to advisers. Clearly, clients should receive advice that is in their best interests.

Chris Bowen

Minister for Human Services, Minister for Financial Services, Superannuation and Corporate Law

¹ The reference to the term 'financial adviser' in this Information Pack generally refers to those who provide 'financial product advice' under the *Corporations Act 2001*.

Reforms to Financial Advice - Summary

The reforms deliver improved quality of advice and enhanced retail investor protection which will underpin investor confidence and trust.

- It reduces key conflicts in adviser remuneration affecting the quality of advice. Advisers must have their own charging structure, which is 'product neutral'.
- It includes a statutory fiduciary requirement for advisers to act in the best interests of their clients and in so doing explicitly place their client's interest before their own.
- It boosts the powers of the Australian Securities and Investments Commission (ASIC) to act against unscrupulous operators.
- It expands the current scope of simple 'intra-fund' advice provided within a superannuation context to other areas of advice which will enhance the trustees' ability to give low cost, simple, compliant advice within a member's superannuation fund.
- It removes the accountants' licensing exemption in relation to self-managed superannuation funds, with appropriate consultation on an appropriate alternative.
- It establishes an expert advisory panel to review professional standards for advisers.
- It appoints an expert, Mr Richard St John, to report on the need for a statutory compensation scheme.
- It reviews the appropriateness of the current method of classifying unsophisticated and sophisticated investors (i.e. retail and wholesale clients).
- It simplifies the disclosure of advisory services provided to consumers.

Timing and implementation of reforms

Stakeholders will be consulted on the implementation of these reforms, with particular emphasis on the adviser charging rules and statutory fiduciary duty, as well as on the legislation implementing the reforms.

The prospective ban on conflicted remuneration structures, adviser charging regime and statutory fiduciary duty will apply from 1 July 2012.

Future of financial advice reforms – Key Points

Removal of conflicted remuneration structures

The reforms will reduce conflicted remuneration structures in relation to advice and distribution of retail financial products (see Attachment B for details). This includes a ban on:

- All commission payments from any financial services business, relating to the distribution and provision of advice for retail financial products².
 - This measure is targeted at removing current potential for product providers to influence adviser recommendations.
- Any form of payment relating to volume or sales targets (including employee sales and volume targets) from any financial services business, relating to the distribution and provision of advice for retail financial products.
 - This measure is targeted at removing other volume-related payments which have similar conflicts to product provider set remuneration. The form of these payments also does not engender the right behaviour.

The reforms will also ensure that percentage-based fees (known as assets under management fees) can only be charged on ungeared products or investment amounts. This measure is targeted at conflicts of interest where an adviser is incentivised to recommend leverage to increase funds under management and hence fees.

- As the PJC Inquiry concluded when examining the Storm Financial collapse, “for at least a sub-set of Storm’s investment clients - the advice to engage in aggressive leveraged investment strategy was clearly inappropriate.”³

The ban applies to all financial products, including managed investment schemes, superannuation and margin loans, but does not initially apply to risk insurance. Insurance has different features from investment products, including the fact that there are no investment funds which might be used to pay for advice. Therefore, concerns about affordability and the potential for under-insurance need to be explored in this context. There will be further consultation about whether to extend the ban to risk insurance (including group insurance).

The ban does not initially apply to soft dollar benefits, due to the varied and complex nature of these payments. The newly established expert advisory panel, in relation to its review of ethical standards, will consider whether these payments are consistent with those standards. Treasury will advise Government to the best way of extending the ban on conflicted remuneration structures to material soft dollar payments.

² A retail financial services product, under the Corporations Act 2001, is defined as a financial product (see s763A for the general definition) that is held by a retail client (see s761G for the meaning of retail client and wholesale client). Section 764A lists the specific things that are defined as financial products. If the client is classified as "retail", then the financial product is a "retail financial services product", and the investor protection provisions contained in Chapter 7 of the Act apply

³ Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services in Australia, paragraph 3.37, page 22.

Legislation will have the capacity to carve out specified payments if unintended payments are captured or unintended consequences occur, as well as covering future or equivalent payments to those ones described above.

Introduction of ‘product neutral’ adviser charging regime

The reforms will introduce an adviser charging regime where financial advice is provided to retail clients. Advisers will be required to agree their fees directly with clients and disclose the charging structure to clients in a clear manner, including as far as practicable, total adviser charges payable, expressed in dollar terms. The Government will consult with industry about the form of the annual renewal notice and the period after which the initial advice is given that it will first apply.

Advisers will only be able to charge ongoing advice fees if a payment plan has been agreed with the client, or if the charge relates to the provision of an ongoing service. If an adviser is to provide an ongoing service, the adviser must send an annual renewal notice to the client. If the client does not renew the services, the adviser cannot continue to charge the client.

It is important to note that the adviser charging regime does not prevent client-agreed deductions being allowed from a client’s investment to pay for financial advice or flexibility in payment options. The client does not have to pay the advice fee, or ongoing fees, up front, and in full. While these deductions from a client’s investment would need to be facilitated by a product provider, this is not a commission, as the remuneration is not set by the product provider. Advisers cannot prefer product providers because this type of service is offered.

There will be consultation with stakeholders on the implementation of adviser charging.

Introduction of a statutory fiduciary duty for financial advisers

In order to ensure that consumers receive personal financial advice that is in their best interests, the reforms will introduce a statutory fiduciary duty on Australian Financial Services Licensees and their authorised representatives which will require them to act in the best interests of their clients. The duty will also clarify that in no circumstances is it permissible for advisers to place their own interests ahead of their clients’ interests.

The duty will include a ‘reasonable steps’ qualification so that advisers and authorised representatives must take ‘reasonable steps’ to discharge the duty but are not expected to base their recommendations on an assessment of every single product available in the market, which would be impractical and costly. This will help to protect retail clients should further conflicts of interest arise.

If the adviser cannot recommend a product that is in the best interests of the client from their own ‘approved product list’ (a list of products that their licensee has authorised them to sell), then the fiduciary duty may require them to search beyond the ‘approved product list’ or recommend that the client should see another adviser.

The detail of the ‘best interests’ formulation, and in particular the ‘reasonable steps’ that must be undertaken will be developed in consultation with industry during implementation.

Other initiatives

Accountants’ licensing exemption

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

Expansion of simple advice provided within a superannuation context

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

Simplify the disclosure of advisory services provided to consumers

- Financial Service Guides will be improved, so they are more effective at disclosing material restrictions on advice, any potential conflicts of interest and remuneration structures. This will be achieved by applying the principles of disclosure simplification developed by the Government's Financial Services Working Group (FSWG), such as designing disclosure to be concise and engaging; focusing on the information the investor needs to know in order to make an informed decision and using clear and unambiguous language.

Enhance the powers of ASIC in relation to licensing and banning of individuals

- The reforms package will strengthen the powers of the corporate regulator, the Australian Securities and Investments Commission (ASIC), in relation to the licensing and banning of individuals from the financial services industry. In relation to licensing, ASIC will be able to take into account a broader range of matters when determining whether to issue a licence, or whether to cancel or suspend a licence. ASIC's powers to remove persons from the industry will also be enhanced, as it will be able to take into account a wider range of matters at the banning stage.
- This will be achieved by adopting ASIC's suggested changes, in its submission to the PJC, which were reflected in recommendations 6 and 8 of the PJC report.
- The reforms to ASIC's powers will enhance the regulator's ability to protect investors by restricting entry into, or removing participants from, the financial services industry who might cause or contribute to investor losses. The reforms are proportionate changes to ASIC powers.

Definition of sophisticated/unsophisticated investor (retail and wholesale client)

- The Government will consult with stakeholders on the appropriateness of the current criterion under which a client is classified as retail or wholesale. The original test was designed to approximate a sophisticated investor and this distinction has not been

reviewed since its introduction almost 10 years ago. The distinction between a retail and wholesale client must remain relevant, as the obligations placed on financial services providers in relation to retail clients recognise the greater protection that unsophisticated investors need.

Review of professional standards

- An expert advisory panel will be established which will review professional standards in the financial advice industry, including conduct and competency standards, which may include a code of ethics for financial advisers. The advisory panel may include members from the industry, professional associations, academia, consumer representatives and ASIC officers.

Expert review of the need for a statutory compensation scheme for financial services

- Mr Richard St John, who has significant corporate law experience, will report on the need for, and costs and benefits of, a statutory compensation scheme.

Financial advice reforms – The Benefits

The key benefit of the reforms will be that consumer trust and confidence in the financial planning industry is strengthened.

Over time, more investors will develop the confidence and trust to seek financial advice as attitudes about perceived conflicts within the industry change. The reforms will improve the quality of financial advice, particularly with respect to product recommendations, and provide strong safeguards for investors.

The measures:

- Improve trust and confidence in the financial planning industry;
- Support the efforts of those in the industry who have already adopted similar business models;
- Clearly align the interests of advisers with their clients and reduce a number of key remuneration based conflicts of interest that can lead to sub-optimal financial advice;
- Address consumer concerns that advisers might favour their own interests over their clients. Consumers will know that their adviser must provide advice that is in their best interests and in the event of a conflict, to prefer the client's interest over that of the adviser;
- Provide transparency for consumers in relation to adviser charging. Adviser charging will be clear, product neutral, directly related to the services provided and must be renewed on an annual basis;
- Facilitate clients paying for advice using flexible payment arrangements, such as the deduction of adviser charges from a client's investments over time;
- Expand the availability of low cost 'simple advice' (intra-fund advice) to support affordability and access to financial advice;
- Enable consumers to better understand the nature of advice services, including any conflicts of interest, such as independence from product providers;
- Enhance the professionalism of the industry, including through new competency and conduct standards;
- Support existing industry moves to transition away from commission payments. The comprehensive approach, where the measures apply across the financial services industry, removes the potential for a first mover disadvantage;
- Provide an opportunity for industry to develop more efficient adviser delivery models; and
- Seek to address issues raised by industry about providing simple advice and will help to clarify the extent to which the provision of this type of advice is permissible under the current legislative and regulatory framework.

The PJC's recommendations and the Government response

Table 1: Summary of the Government response

Rec	PJC Recommendation	Summary of Government response
1	The committee recommends 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.	Support.
2	The committee recommends that the Government ensure ASIC is appropriately resourced to perform effective risk-based surveillance of the advice provided by licensees and their authorised representatives. ASIC should also conduct financial advice shadow shopping exercises annually.	Support in principle. ASIC is appropriately resourced to perform its functions.
3	The committee recommends that the Corporations Act be amended to require advisers to disclose more prominently in marketing material restrictions on the advice they are able to provide consumers and any potential conflicts of interest.	Do not support.
4	The committee recommends 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.	Support with additional strengthening.
5	The committee recommends that the Government consider the implications of making the cost of financial advice tax deductible for consumers as part of its response to the Treasury review into the tax system.	The Government's response to the <i>Independent Tax Review</i> will be released on 2 May 2010
6	The committee recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry.	Support.
7	The committee recommends that, as part of their licence conditions, ASIC require agribusiness MIS (managed investment scheme) licensees to demonstrate they have sufficient working capital to meet current obligations.	Support in principle, noting that implementation is a matter for ASIC.
8	The committee recommends that sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence.	Support.
9	The committee recommends that ASIC immediately begin consultation with the financial services industry on the establishment of an independent, industry-based professional standards board to oversee nomenclature, and competency and conduct standards for financial advisers.	Do not support.
10	The committee recommends that the Government investigate the costs and benefits of different models of a statutory last resort compensation fund for investors.	Support.
11	The committee recommends that ASIC develop and deliver more effective education activities targeted to groups in the community who are likely to be seeking financial advice for the first time.	Support in principle.

Additional Government Proposals		
1	The exemption permitting accountants to provide advice on the establishment and closing of self-managed superannuation funds (SMSFs) without holding an Australian Financial Services Licence (AFSL) will be removed.	Additional Government proposal
2	Improve and simplify disclosure on the nature of financial services offered to investors.	Additional Government proposal
3	Consult on the appropriateness of the current criterion under which a client is classified as retail or wholesale.	Additional Government proposal
4	Improve access to simple or limited advice to assist in the affordability of advice, by removing regulatory barriers.	Additional Government proposal

Table 2: Summary of the differences between the PJC's recommendations and the Government response

Rec	Summary of the difference (if any)	Explanation for the difference
3	The PJC recommended that advisers disclose more prominently in marketing material restrictions on advice they can provide and potential conflicts of interest. Rather than focusing on disclosure through marketing material, the Government considers it is more appropriate to improve the disclosure of financial advice services to investors through the simplification of disclosures made in the Financial Services Guide (FSG).	The PJC recommendation is not supported because it is difficult for a range of restrictions on advice and conflicts of interests to be meaningfully disclosed to consumers in the form of various kinds of marketing material. The Government acknowledges that it is important for consumers to better understand the nature of advice services on offer. For example, it is important for investors to understand any potential conflicts of interest, such as whether their adviser is independent from product providers. Here the Government is already acting to improve the disclosure of advisory services to consumers, through simplifying the disclosure of advisory services contained in the Financial Services Guide (a pre-sale disclosure document). This will be achieved by applying the principles of disclosure simplification developed by the Financial Services Working Group (Working Group), such as designing the disclosure to be concise and engaging, focusing on the information the investor needs to know in order to make an informed decision, and using clear and unambiguous language.
4	The PJC recommended that the Government consult and support industry in developing an appropriate mechanism to cease payments from product manufacturers to financial advisers. The Government proposal strengthens the recommendation by introducing a legislative ban on conflicted remuneration structures, including payments from product providers to financial planners. Furthermore, the reforms strengthen the PJC recommendation by including other conflicted incentives such as asset-based fees in relation to geared products or investment amounts and extending these standards to superannuation products and	The legislative approach is important to support the steps that some industry members have been taking in transitioning away from commission payments, by establishing a single legislative framework that applies to the retail financial services industry as a whole. This is necessary for the ban to be effective in addressing the distortions the remuneration structures create.

	services.	
9	The PJC recommended that ASIC consult on the establishment of a Professional Standards Board. The Government proposal involves a review of professional standards, including competency and conduct standards, with a view to enhancing conduct standards for advisers in order to improve the quality of advice. This would involve establishing an expert advisory panel which may include members from the industry, professional associations, academia, consumer representatives and ASIC officers.	The Government acknowledges that the current arrangements for professional standards could be enhanced, and may benefit from increased stakeholder participation in the setting of competency and conduct standards. However, the Government considers that the establishment of a Professional Standards Board (PSB) is a matter for Government not ASIC. Furthermore, the Government is concerned about the costs of a separate PSB, which may be passed to consumers, and for the potential for significant overlap with the role of ASIC in enforcing competency and conduct standards.
Discussion of additional Government proposals		
1	The PJC did not make a recommendation on the accountants' exemption because superannuation was outside the scope of the Inquiry. However a number of submissions to the PJC (and the Cooper Review) raised concerns with and highlighted the shortcomings of the accountants' licensing exemption.	Since 2004, recognised accountants (who have membership of at least one of three specific accounting bodies) have been exempt from the requirement to be licensed when providing advice concerning the acquisition or disposal of an interest in a self-managed superannuation fund (SMSF). However, various stakeholders, including those representing self-managed superannuation professionals, have raised issues about the appropriateness of the exemption. The Government agrees that the exemption is not operating appropriately, and proposes to remove it. Furthermore, proposed consultation with the industry (including relevant professional bodies) would consider all alternative options, such as a more streamlined licensing regime.
2	See discussion under recommendation 3 above, relating to improved disclosure of FSGs.	
3	The PJC did not make a recommendation in relation to the categorisation of wholesale and retail clients.	<p>The distinction between a retail and wholesale client is important in the regulation of financial services. The obligations placed on financial services providers in relation to retail clients recognise the greater protection that unsophisticated investors need. This distinction has not been reviewed since its introduction in 2001.</p> <p>The Government proposal will involve consulting with industry and reviewing the appropriateness of the current criterion under which a client is classified as retail or wholesale. The Government considers that a review of mechanisms for determining whether a client is classified as wholesale or retail is appropriate, to ensure the distinction remains relevant, including a review of current thresholds for determining wholesale or retail status.</p>
4	The PJC did not make a recommendation in relation to simple advice but did consider the affordability of advice generally.	<p>The Government considers that access to simple advice is an important issue, where this suits the client's needs. The provision of simple advice also assists with the affordability of advice issue. Some industry members have suggested there is uncertainty concerning whether the current regulatory regime enables the provision of simple financial advice.</p> <p>The Government's proposal builds on the existing success</p>

		of the intra-fund advice project on superannuation advice, and seeks to address broad issues raised by industry around regulatory barriers to providing low-cost, compliant, simple advice.
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Reforms to Financial Advice– Adviser Remuneration

Form of Remuneration	Description	Permitted under the new regime
Initial/upfront commission	Advice fee charged as a percentage of the client's initial investment. The fee is an arrangement between the product provider and the adviser or the adviser's licensee and built into the product. The fee may be funded by a matching contribution or entry product fee.	Not permitted. There must be separate fees for the product and advice.
Trail commission	Charged as a percentage of the client's assets (for example annually). The fee is an arrangement between the product provider and the adviser or the adviser's licensee and built into the product. The fee may be funded by a product administration fee.	Not permitted. There must be separate fees for the product and advice.
Fee for service charged as an asset-based fee on <u>un-gearred products or investment amounts</u> .	A fee for service, agreed between the client and the adviser, charged as a percentage of the client's funds under management and paid by the client to the adviser or licensee in relation to the provision of advice. This asset-based fee can be deducted from the client's investment, at the direction of the client.	Permitted.
Fee for service charged as an asset-based fee on geared products or investment amounts.	Advice fee charged as a percentage of the client's funds under management and paid by the client to the adviser or licensee in relation to the provision of advice.	Not permitted.
Other types of fee for service for advice	May be charged, for example, as an hourly rate, flat fee per service provided, fixed annual fee (a retainer) or performance or outcome based fees. This may be paid up front, deducted from the client's investment funds at the direction of the client or through a payment plan (if offered by the adviser).	Permitted.
Any form of payment based on volume or sales targets (examples are below)	Whether this is in the form of a payment, from a product provider, or from any financial services business, in relation to the distribution or advice for retail financial products.	Not permitted.
<i>Volume based</i> Volume bonus and fee rebate	Paid by the product provider to the licensee or adviser and is generally conditional on the licensee having large funds under management (FUM) with the product.	Not permitted.
<i>Volume based</i> Volume based payments or sales incentives	Payments from licensees to their employee advisers or authorised representatives for distribution of retail financial products, which are calculated based on meeting sales targets	Not permitted.

	or are volume based.	
<i>Volume based</i> Shelf space fee payments (based on volume)	Payments based on volume that are paid from the fund manager to the platform provider and from the platform provider to the licensee.	Not permitted.
Shelf space fee payments (not based on volume)	Payments not based on volume that flow to and from the platform, including a product access payment (provided that payment is not based on volume).	Permitted.

Note: Any form of non-permitted remuneration described above would not be allowed after 1 July 2012. The reform applies to all financial products, with the exception of risk insurance. The application of the reforms to risk insurance will be considered at a later date.