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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011

REPLACEMENT EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Minister for Financial Services and Superannuation, the Hon Bill Shorten MP.)

THIS MEMORANDUM REPLACES THE EXPLANATORY MEMORANDUM
PRESENTED TO THE HOUSE OF REPRESENTATIVES ON
13 OCTOBER 2011

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
AAT	Administrative Appeals Tribunal
ASIC	Australian Securities and Investments Commission
Bill	Corporations Amendment (Future of Financial Advice) Bill 2011
Corporations Act	*Corporations Act 2001*
FOFA	Future of Financial Advice
Licence	Australian Financial Services Licence
Licensee	Holder of an Australian Financial Services Licence
PJC Inquiry	*Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services (2009)*

General outline and financial impact

Outline

On 26 April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, announced the Future of Financial Advice (FOFA) reforms.

The FOFA reforms represent the Government's response to the 2009 *Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services* (PJC Inquiry), which considered a variety of issues associated with corporate collapses, including Storm Financial and Opes Prime.

The Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) implements the first components of the FOFA reforms. The reforms focus on the framework for the provision of financial advice. The underlying objective of the reforms is to improve the quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest. The reforms also focus on facilitating access to financial advice, through the provision of simple or limited advice. To this end, the Bill sets up a framework with the following features:

- a requirement for providers of financial advice to obtain client agreement to ongoing advice fees and enhanced disclosure of fees and services associated with ongoing fees (charging ongoing fees to clients); and
- enhancement of the ability of the Australian Securities and Investments Commission (ASIC) to supervise the financial services industry through changes to its licensing and banning powers.

The reforms also include the introduction of a requirement for advisers to act in the best interests of clients and a ban on conflicted remuneration, including commissions, volume payments and soft-dollar benefits. These measures will be implemented through the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

It should be noted that the Rice Warner research referred to in the attached Regulatory Impact Statement was updated in January 2012 to take account of policy changes made since the research was conducted in March 2010. Rice Warner now estimates that total adviser employment will be 17,068 at 30 June 2022 compared to 17,711 at 30 June 2012.

Date of effect: The reforms commence on 1 July 2012.

Proposal announced: On 26 April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, announced the FOFA reforms. On 28 April 2011, further detail on the operation of the FOFA reforms was announced by the Assistant Treasurer and Minister for Financial Services and Superannuation, the Hon Bill Shorten MP.

Financial impact: This Bill has no significant financial impact on Commonwealth expenditure or revenue.

Regulatory Impact: The measure relating to charging ongoing fees to clients will be subject to a Post Implementation Review.

Chapter 1
Charging ongoing fees to clients

Outline of chapter

1.1 Schedule 1 to the Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) amends the *Corporations Act 2001* (Corporations Act) to require financial advisers (persons who hold a licence with an authorisation to provide financial product advice or their representatives) to obtain their retail clients' agreement in order to charge them ongoing fees for financial advice. ***[Schedule 1, item 10, division 3]***

Context of amendments

1.2 Financial advisers are traditionally remunerated differently from other occupations. For example, many advisers have traditionally received commissions from product providers for placing clients with particular products, sometimes paid as a percentage of funds under management. Some commissions are ongoing in nature, forming what are known as 'trail' commissions.

1.3 In situations where the client pays a substantial proportion of the adviser's remuneration directly (known as 'fee for service') it is common for this remuneration to be ongoing in nature. For example, an adviser might charge a client an ongoing annual fee calculated as a percentage of the client's funds under management (known as an asset-based fee) or a flat dollar amount. This annual fee generally covers a range of advisory services provided to (or available to) clients. As opposed to professions or other occupations that tend to charge for transactional, one-off services or advice, advisers' remuneration structure is partly reflective of the notion that the benefits of financial advice tend to be realised over the medium to long-term, and therefore remuneration structures tend to reflect the ongoing nature of the adviser-client relationship.

1.4 As a result of this unique remuneration structure, in some situations clients of advisers that pay ongoing fees for financial advice receive little or no service. Of the clients that do receive a service for the fees they are paying, some are unaware of the precise magnitude of those fees (or the fees advisers are receiving from third parties) or they continue paying ongoing fees as a result of their own disengagement. This is despite the fact that most ongoing advice contracts allow a client to 'opt-out' at any time.

1.5 The concept of compulsory renewal of ongoing advice fees, requiring the active renewal by the client to ongoing fees, is designed to protect disengaged clients from paying ongoing financial advice fees where they are receiving little or no service. For those clients that are not disengaged, the renewal requirement will provide them with an opportunity to consider whether the service they are receiving equates to value for money.

1.6 Although ongoing fees are disclosed to clients upon engagement of the adviser's services (via the Statement of Advice requirement prescribed under the Corporations Act), there is no ongoing advice fee disclosure requirement. This initial disclosure requirement alone is not a guaranteed safeguard for clients that become disengaged after a number of years of 'passively' paying ongoing advice fees.

Summary of new law

1.7 Where an ongoing financial advice relationship exists between an adviser (the 'fee recipient') and a retail client which involves the charging of an ongoing advice fee (however described), the fee recipient is required to discharge two separate (albeit intertwined) obligations.

1. Disclosure obligation: In order to continue charging an ongoing fee for a period longer than 12 months, the fee recipient must provide a fee disclosure statement to the client outlining fee and service information relevant to the client.
2. Renewal notice obligation: In order to continue charging an ongoing fee for a period longer than 24 months, the fee recipient must provide both a fee disclosure statement and a renewal notice to the client.

1.8 If the fee recipient does not fulfil these obligations, the client is not liable to continue paying the ongoing advice fee past the relevant 12 or 24 month period.

1.9 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. This means that the fee recipient is not obligated to provide ongoing financial advice to the client, and the client is not obligated to continue paying the ongoing fee.

Comparison of key features of new law and current law

New law	***Current law***
In order to charge an ongoing advice fee to a retail client for a period of longer than 12 months, the fee recipient will be required to provide a fee disclosure statement to the client detailing advice fee and service information for the previous 12 months.	There is no requirement under the current law for advisers/fee recipients to provide ongoing disclosure of advice fees to retail clients.
In order to charge an ongoing advice fee to a retail client for a period of longer than 24 months, the fee recipient will be required to provide a renewal notice and a fee disclosure statement to the client, which will detail advice fee and service information for the previous 12 months. If the client opts not to renew the arrangement with the fee recipient, or does not respond to the renewal notice, the arrangement ceases and an ongoing advice fee can no longer be charged to the retail client.	There is no requirement under the current law for advisers/fee recipients to obtain the agreement of retail clients to continue charging ongoing advice fees.
For ongoing fee arrangements, the client can 'opt-out' or terminate the arrangement at any time.	There is no implied term under the current law that retail clients have the right to opt-out of ongoing financial advice arrangements at any time (however, it is a common practice in the industry to allow clients to opt-out at any time).

Detailed explanation of new law

Preliminary

1.10 Key terms that are used in Part 7.7A of the Bill are defined. Relevant discussion of these terms is contained in the relevant parts of the Explanatory Memorandum. The Bill also specifies that it is not possible to contract out of the requirements imposed by Part 7.7A. ***[Schedule 1, item 10, division 1, sections 960 and 960A]***

Application

1.11 The compulsory disclosure and renewal notice obligations will apply to advisers ('fee recipients') in situations where they provide personal advice to a retail client, and the client pays a fee which does not relate to advice that has already been given at the time the arrangement is entered into. This is so the compulsory disclosure and renewal notice obligations apply to ongoing advice fees. ***[Schedule 1, item 10, division 3, sections 962, 962A and 962B]***

1.12 In practical terms, these obligations only become relevant to fee recipients when an ongoing fee is to be charged for a period of 12 months or more. ***[Schedule 1, item 10, division 3, sections 962 & 962A]***

1.13 An ongoing fee paid by a product issuer or other third party to a financial services licensee or representative of a financial services licensee will not constitute a fee for the purposes of section 962A(1)(c) or section 962A(2)(c) unless the fee is paid under the terms of the arrangement between the client and the financial services licensee or the representative of the financial services licensee. Fees paid by product issuers or other third parties will not generally be considered to be paid under the terms of the arrangement unless the fee is paid at the direction of or with the clear consent of the client. ***[Schedule 1, item 10, division 3, subsection 962A]***

1.14 Fees paid by product issuers to financial services licensees or representatives which relate to products acquired by clients of the licensee or representative are generally required to be disclosed in the periodic statements given by product issuers to retail clients under section 1017D of the Corporations Act. The Government intends to make regulations under paragraph 1017D(5)(g) and section 1017DA of the Corporations Act to improve the transparency of this disclosure.

1.15 The Bill also specifies several sorts of arrangements that are not ongoing fee arrangements. Where a person is making ongoing payments to a fee recipient via instalments for advice that has already been provided by a fee recipient before the arrangement is entered into, for example a 'payment plan', such an arrangement is not characterised as an ongoing fee arrangement. This ensures that a client cannot opt-out of paying a fee they genuinely owe in respect of services already rendered by the fee recipient. ***[Schedule 1, item 10, division 3, subsection 962A(3)]***

1.16 However, exempt 'payments by instalments' must possess the features one would reasonably anticipate to see in a 'payment plan'. For example, the amount of money owed by the client must be fixed and specified in the terms of the arrangement, and the client must not have a right to opt-out at any time. If a client has the right to unilaterally opt-out of paying an ongoing fee, it is highly unlikely to be regarded as a payment plan for advice services already provided to the client. ***[Schedule 1, item 10, division 3, subparagraphs 962A(3)(a), (b) & (f)]***

1.17 If the fee recipient charges the ongoing fee as an asset-based fee (that is, a fee calculated as a percentage of funds under advice or management), then the ongoing fee cannot be reasonably regarded as a payment plan for advice by instalments. It is highly unlikely that a genuine payment plan for advice services already provided to the client (or for which the cost is finite and fixed) would need to be charged as an asset-based fee. ***[Schedule 1, item 10, division 3, subparagraphs 962A(3)(e)]***

1.18 The types of ongoing fee arrangements intended to be captured are those ongoing fees that are being charged for personal financial advice (including where the client is not actually receiving ongoing advice but still paying a fee to an adviser). The ongoing payment of an insurance premium or a product fee is therefore not intended to be captured as an ongoing fee arrangement. ***[Schedule 1, item 10, division 3, subsections 962A(4)&(5)]***

1.19 The regulations can prescribe kinds of product fees which are not ongoing fee arrangements. It is important for the regulations to have this degree of flexibility to exclude certain kinds of arrangements. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to exclude certain arrangements that this obligation is not intended to apply to, including arrangements that may not currently exist. This regulation-making power therefore serves several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants that are unintentionally captured, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subsection 962A(5)]***

1.20 Depending on who the client enters into the ongoing fee arrangement with, either a licensee or a representative of a licensee can be an ongoing fee recipient. ***[Schedule 1, item 10, division 3, subsections 962C(1)&(2)]***

1.21 Where the rights of a licensee or representative under an ongoing fee arrangement have been transferred to another person (for example, where the rights under a book of business are transferred from one advice business to another), the new holder of those rights is considered to be the fee recipient. ***[Schedule 1, item 10, division 3, subsection 962C(3)]***

Disclosure obligation

1.22 If an ongoing fee arrangement is to remain in place for a period longer than 12 months, the fee recipient is required to provide the client with a fee disclosure statement before the end of a period of 30 days beginning on the 12 month anniversary of the day the arrangement was entered into (or, if a fee disclosure statement has been given to the client since the arrangement was entered into, before the end of a period of 30 days beginning on the 12 month anniversary of the day immediately after final day of the year for which disclosure was provided in the last fee disclosure statement). ***[Schedule 1, item 10, division 3, subsection 962G(1) and section 962J]***

1.23 The fee disclosure statement will need to contain fee information to assist the client in ascertaining whether they are receiving a service from their fee recipient commensurate with the ongoing fee that they are paying. Information to be contained in the statement would include fee and service information about the previous 12 months. ***[Schedule 1, item 10, division 3, subsections 962H(1)&(2)]***

1.24 The regulations may provide that details of any other prescribed matters must also be included in the fee disclosure statement. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to add additional details to be contained in the fee disclosure statement, including details about certain remuneration arrangements that may not currently exist. This regulation-making power therefore serves several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subparagraph 962H(2)(d)]***

1.25 The regulations may provide that certain information is not required to be contained in a fee disclosure statement, or that a more detailed statement of the information required be included. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to expand or shorten the information to be disclosed to clients. This regulation-making power therefore serves several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subsection 962H(3)]***

1.26 Where the disclosure obligation coincides with the renewal notice obligation (which applies every 24 months to ongoing fee arrangements) the fee disclosure statement will serve the additional purpose of assisting the client to decide whether they should renew the ongoing fee arrangement.

1.27 If the fee recipient does not comply with the requirement to provide the fee disclosure statement within the specified time, the client is not liable to continue paying the ongoing fee. This is the case whether it is the previous or the current fee recipient that failed to comply with the disclosure requirement. ***[Schedule 1, item 10, Division 3, subsection 962F(1)]***

1.28 The client is not taken to have waived their rights or to have entered into a new ongoing fee arrangement by merely continuing to pay an ongoing fee after a breach of the disclosure obligation. This is because often the mechanism by which clients pay for ongoing advice services is through an automated process (for example, by a monthly direct debit from the client's investment). ***[Schedule 1, item 10, division 3, subsection 962F(2)]***

1.29 If a client makes a payment of an ongoing fee after a failure to comply with the disclosure obligation, the fee recipient is not obliged to refund the payment in full. A statutory right of a client to a full refund of any ongoing fee charged after a failure to discharge the disclosure obligation would, while simple in principle, potentially result in a disproportionate and unjust result at the expense of the fee recipient. For example, such a statutory right would mean that one single accidental breach by a fee recipient could result in the forced refund of advice fees over a number of years, regardless whether the client continued to engage and access the services of the fee recipient. ***[Schedule 1, item 10, division 3, subsection 962F(3)]***

1.30 However, the client (or ASIC) has the right to apply to the Court for a refund where a fee recipient has knowingly or recklessly continued to charge a client ongoing fees after an arrangement has terminated as a result of breaching the disclosure or renewal obligations. This ensures the client has a right to redress, but fee recipients can be certain that the Court would only make an order to refund the money where it is reasonable in the circumstances to do so. ***[Schedule 1, item 13, division 6, section 1317GA]***

1.31 Even where the identity of the fee recipient changes (for example, where a fee recipient sells a 'book' of business to another fee recipient) and it was the previous fee recipient that failed to comply with the fee disclosure obligation, this does not alter the fact that the client is not liable to continue paying the ongoing fee. ***[Schedule 1, item 10, division 3, subsection 962F(1)]***

1.32 The regulations may provide that the requirement to provide a fee disclosure statement does not apply in certain situations. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to exclude certain arrangements that this obligation is not intended to apply to, including arrangements that may not currently exist. This regulation-making power therefore serves several functions, including providing a mechanism to help keep the legislation up to date and provide commercial certainty quickly and efficiently to industry participants that are unintentionally exposed to the disclosure obligation, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subsection 962G(2)]***

Renewal obligation

1.33 If an ongoing fee arrangement is to remain in place for a period longer than 24 months, the fee recipient is required to provide the client with a renewal notice before the end of a period of 30 days beginning on the 24 month anniversary of the day the arrangement was entered into (or, if the arrangement has since been renewed, before the end of a period of 30 days beginning on the 24 month anniversary of the last day on which that arrangement was renewed). ***[Schedule 1, item 10, division 3, subsection 962K(1) and section 962L]***

1.34 The renewal notice will need to contain information indicating that the client may renew the ongoing fee arrangement. It will also contain information setting out what will happen if the client elects not to renew the arrangement, or if they do not respond to the renewal notice, in particular, that the arrangement (including the provision of advice and the ongoing fee) will terminate. Fee recipients may choose to elaborate in the renewal notice on the potential deleterious consequences to the client if they do not renew the ongoing fee arrangement including, for example, that they will lose access to ongoing advice including in situations where they may value it most (for example, in times where there are sudden shocks to capital markets). ***[Schedule 1, item 10, division 3, subsection 962K(2)]***

1.35 Because fee recipients will be required to provide a fee disclosure statement at the same time they provide a renewal notice to the client, the fee disclosure statement will also assist the client in deciding whether they should agree to renew the ongoing fee arrangement. Where the fee recipient is required to send a client both the fee disclosure statement and renewal notice, it is expected that fee recipients will be able to satisfy both of these requirements by providing one comprehensive notice containing all of the requisite information.

1.36 It is envisaged that the fee disclosure statement and renewal notice could take simple forms. Provided the required information is contained in those notices, fee recipients have flexibility in how they present these documents.

1.37 If the fee recipient does not comply with the requirement to provide the renewal notice within the specified time, the client is not liable to continue paying the ongoing fee. This is the case whether it is the previous or the current fee recipient that failed to comply with the renewal requirement. ***[Schedule 1, item 10, Division 3, subsection 962F(1)]***

1.38 The client is not taken to have waived their rights or to have entered into a new ongoing fee arrangement by merely continuing to pay an ongoing fee after a breach of the renewal obligation. This is because often the mechanism by which clients pay for ongoing advice services is through an automated process (for example, by a monthly direct debit from the client's investment). ***[Schedule 1, item 10, division 3, subsection 962F(2)]***

1.39 If a client makes a payment of an ongoing fee after a failure to comply with the renewal obligation, the fee recipient is not obliged to refund the payment in full. A statutory right of a client to a full refund of any ongoing fee charged after a failure to discharge the renewal obligation would, while simple in principle, potentially result in a disproportionate and unjust result at the expense of the fee recipient. For example, such a statutory right would mean that one single accidental breach by a fee recipient could result in the forced refund of advice fees over a number of years, regardless whether the client continued to engage and access the services of the fee recipient. ***[Schedule 1, item 10, division 3, subsection 962F(3)]***

1.40 However, the client (or ASIC) has the right to apply to the Court for a refund where a fee recipient has knowingly or recklessly continued to charge a client ongoing fees after an arrangement has terminated as a result of breaching the disclosure or renewal obligations. This ensures the client has a right to redress, but fee recipients can be certain that the Court would only make an order to refund the money where it is reasonable in the circumstances to do so. ***[Schedule 1, item 13, division 6, section 1317GA]***

1.41 Even where the identity of the fee recipient changes (for example, where a fee recipient sells a 'book' of business to another fee recipient) and it was the previous fee recipient that failed to comply with the renewal notice obligation, this does not alter the fact that the client is not liable to continue paying the ongoing fee. ***[Schedule 1, item 10, division 3, subsection 962F(1)]***

1.42 The regulations may provide that the requirement to provide a renewal notice does not apply in certain situations. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to exclude certain arrangements that this obligation is not intended to apply to, including arrangements that may not currently exist. It therefore serves several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants that are unintentionally exposed to the renewal notice obligation, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subsection 962K(3)]***

Flexibility of disclosure and renewal notice obligations

1.43 The fee disclosure statement and the renewal notice are required to be provided before the end of a period of 30 days beginning on the relevant anniversary date (12 months since the arrangement began in respect of the disclosure obligation, and 24 months since the arrangement began in respect of the renewal notice obligation). As such, a fee recipient can provide these notices in advance of the prescribed time periods in order to satisfy the obligations sooner than is actually required if it is convenient to do so. To the extent these obligations are fulfilled by fee recipients in advance of the prescribed periods, the time within which these obligations need to be fulfilled in the future will 'reset', with the creation of new disclosure and renewal notice days. ***[Schedule 1, item 10, division 3, section 962J and subsection 962L(1)]***

1.44 This provides flexibility for fee recipients in choosing when they discharge these obligations. For example, if the fee recipient and client have a face-to-face meeting well in advance of the disclosure or renewal notice days, they can take the opportunity to provide these notices or obtain their client's agreement to renew in advance of the applicable anniversary.

Opt-out process

1.45 The renewal notice requirement establishes a framework by which clients are asked by the fee recipient if they wish to renew the ongoing fee arrangement. If the client does not actively renew that agreement within the renewal period, the client is assumed to have opted out of the ongoing fee arrangement.

1.46 If the client communicates to the fee recipient in writing within the renewal period that they do not wish to renew the ongoing fee arrangement, the arrangement terminates on the day on which the notification is given. If notification is sent by post, the notification will be taken to have been given at the time at which the letter would be delivered in the ordinary course of post in accordance with s29(1) of the *Acts Interpretation Act 1901* (Cth). ***[Schedule 1, item 10, division 3, section 962M]***

1.47 If the client does not notify the fee recipient in writing that they wish to renew the ongoing fee arrangement, the arrangement terminates at the end of an additional 30 days after the renewal period. The Bill infers a client's failure to respond to a renewal notice to mean that the client does not wish to renew the ongoing fee arrangement. This might be due either to the client's disengagement or to a conscious decision by the client not to actively renew because, for example, they considered they were not receiving value for the fees they were paying. ***[Schedule 1, item 10, division 3, section 962N]***

1.48 Although there is a built-in 30 day 'grace period' where a client opts-out by failing to respond to a renewal notice, this grace period can be cut short should the fee recipient make contact with the client during the grace period. The grace period can be shortened either by agreement between the fee recipient and client, or by the client exercising their right to terminate.

1.49 In terms of clients notifying the fee recipient in writing of their decision to renew or not renew the ongoing fee, this can be administered flexibly and by using a range of mediums and technologies. The manner in which 'writing' is defined in s25 of the *Acts Interpretation Act 1901* (Cth) means that the client can notify the fee recipient in a number of recordable forms, including by facsimile, email, SMS, or through an online facility.

1.50 If an ongoing fee arrangement terminates for any reason, including, for example, because a client opts out, and the fee recipient continues to charge the ongoing fee, they will be subject to a civil penalty. Because a breach of such a provision is likely to be relatively less serious than, for example, a breach of the best interests duty, it is subject to lower maximum civil penalties ($50,000 for an individual and $250,000 for a body corporate). ***[Schedule 1, item 10, division 3, section 962P]***

1.51 It is expected that maximum penalties would apply only in the most serious of breaches of these provisions. Simpler breaches, for example where a single breach is accidental, would attract a smaller proportionate penalty (to the extent any action is taken at all).

1.52 The ongoing fee arrangement contains an imported term that the client may terminate the arrangement at any time. This is intended to prevent clients being locked into fixed term ongoing fee arrangements as a result of the new disclosure and renewal notice obligations. It also reflects a right that clients currently enjoy as a matter of common practice within the financial planning industry. ***[Schedule 1, item 10, division 3, sub section 962E(1)]***

1.53 To ensure that clients will not be deleteriously impacted as a result of their right to terminate the arrangement at any time, the Bill voids any condition of an ongoing fee arrangement that requires a client to pay an amount on terminating the ongoing fee arrangement to the extent the amount exceeds the sum of any liability that the client has accrued but not satisfied before the termination, or the costs the fee recipient has incurred solely and directly because of the termination.

1.54 This effectively prohibits fee recipients from applying an ‘exit’ or ‘penalty’ fee to clients that choose to exercise their right to terminate an ongoing fee arrangement. However, this would not prevent a fee recipient from recovering monies already owed by the client (for example, for services already rendered). ‘Exit’ fees remain permissible to the extent that they represent no more than a cost-recovery fee incurred as a result of the termination, which in most situations is likely to constitute only a modest sum. ***[Schedule 1, item 10, division 3, subsection 962E(2)]***

1.55 To the extent the continued provision of a service by the fee recipient is dependent on the continued payment of an ongoing fee under the ongoing fee arrangement, the obligation to continue to provide the service also terminates. This provides certainty to the fee recipient that in most cases their obligation to provide continued advice services ceases after termination, as does their liability for the failure to provide continued advice services.

1.56 This clarification is particularly important for the situation that arises where the client does not consciously choose to opt-out, but terminates the ongoing fee arrangement by virtue of failing to respond to the fee recipient’s renewal notice. While a fee recipient remains liable for any advice they have provided prior to termination, they cannot be liable for client losses as a result of failure to provide advice to a client after termination (for example, in the event of sudden movements in capital markets after the ongoing fee arrangement has terminated). Fee recipients may wish to emphasise these matters to the client when they provide them with the renewal notice. ***[Schedule 1, item 10, division 3, section 962Q]***

Disclosure requirement to all clients

1.57 Fee recipients must, before the end of a period of 30 days beginning on the 12 month anniversary of the day the arrangement was entered into, give the client a fee disclosure statement in regard to all ongoing fee arrangements to which the other disclosure and renewal obligations do not apply. Essentially, fee recipients must provide fee disclosure notices to all of their clients that they currently have ongoing fee arrangements with, including where those arrangements began or the clients were engaged prior to the commencement day. ***[Schedule 1, item 10, division 3, sections 962R & 962S]***

1.58 The regulations may provide that the requirement to provide a fee disclosure statement does not apply in certain situations. The diversity and complexity of the financial services industry make it necessary for the Minister to be able to exclude certain arrangements that this obligation is not intended to apply to, including arrangements that may not currently exist. This regulation-making power therefore serves several functions, including providing a mechanism to help keep the legislation up to date and provide commercial certainty quickly and efficiently to industry participants that are unintentionally exposed to the disclosure obligation, and to provide efficacy to the legislation. ***[Schedule 1, item 10, division 3, subsection 962S(2)]***

Application and transitional provisions

1.59 Subdivision B (Termination, disclosure and renewal) applies only to ongoing fee arrangements entered into on or after the commencing day and where the client has not received financial advice from the licensee prior to the commencing day. ***[Schedule 1, item 10, division 3, section 962D]***

1.60 This essentially means that subdivision B will only apply to new clients.

1.61 If a licensee or representative transfers their 'grandfathered' rights under an ongoing fee arrangement to another licensee or representative after the commencement date (for example, when selling a book of business), this is unlikely to 'trigger' the application of subdivision B if the character of the arrangement does not change. However, it will depend on the facts and circumstances of each arrangement and transfer. If a transfer of business results in the arrangement changing character to such a degree that it essentially becomes a new arrangement, subdivision B may apply to that new arrangement. It is up to fee recipients to determine on a case by case basis whether a transfer in business results in the creation of a new arrangement to which the additional obligations would apply.

1.62 Subdivision C (Disclosure for arrangements to which subdivision B does not apply) applies to all arrangements to which subdivision B does not apply. Essentially, this disclosure obligation applies in relation to 'existing clients' or 'existing ongoing fee arrangements' which were in place prior to commencement. ***[Schedule 1, item 10, division 3, section 962R]***

Anti-avoidance

1.63 The Bill contains an anti-avoidance provision which prevents a person from entering into a scheme if the sole or dominant purpose of doing so was to avoid the application of any provision in Part 7.7A. ***[Schedule 1, item 10, division 6, section 965(1)]***

1.64 The anti-avoidance provision will not apply to the extent that its operation would result in an acquisition of property otherwise than on just terms. ***[Schedule 1, item 10, division 6, section 965(2)]***

1.65 The Bill sets out the provisions in Part 7.7A which are subject to civil penalties (if breached), and establishes a lower maximum civil penalty of $50,000 for an individual and $250,000 for a body corporate (for example, if a fee recipient charges an ongoing fee after termination or fails to give a disclosure notice). The lower maximum fees reflect the fact that a breach of the ongoing fee or disclosure requirements are relatively minor compared to other breaches of civil penalty provisions in the Corporations Act. However, contravention of the anti-avoidance provision will be subject to the standard maximum penalties of $200,000 for an individual and $1 million for a body corporate. ***[Schedule 1, items 11 and 12, division 6]***

1.66 If a fee recipient continues to knowingly or recklessly charge a client an ongoing fee after the termination of the relevant ongoing fee arrangement, the Court can make an order for the fee recipient to refund the fees to the client. However, a Court may only order the payment of a refund if it is reasonable in all the circumstances to do so. The Court may make the order on its own initiative, on application by ASIC or the client. ***[Schedule 1, item 13, division 6, section 1317GA]***

Chapter 2
Enhancements to ASIC's licensing and banning powers

Outline of chapter

2.1 Schedule 1 to the Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) amends the *Corporations Act 2001* (Corporations Act) to enhance the ability of the Australian Securities and Investments Commission (ASIC) to supervise the financial services industry through changes to its licensing and banning powers. ***[Schedule 1, items 2 to 9]***

Context of amendments

2.2 ASIC is responsible for regulating persons who carry on a financial services business in Australia.

2.3 Those persons who wish to carry on a business of providing financial services are generally required to hold an Australian financial services licence (licence), issued by ASIC.

2.4 Adequate licensing thresholds provide a basic screening process to facilitate investor confidence that financial services providers have appropriate skills, experience and qualifications, are of good character and that they are required to provide services with honesty and integrity. The licensing regime also enhances ASIC's ability to supervise the financial services industry.

2.5 ASIC must grant a licence if certain criteria are satisfied. This includes that ASIC is satisfied that there is no reason to believe that the applicant is not of good fame or character. ASIC must also have no reason to believe that the applicant will not comply with its obligations as a licensee. As long as these criteria are met and the application is made properly, ASIC must grant the applicant a licence, as it does not have the ability to refuse a licence on any other grounds.

2.6 A common exemption from the need to obtain a licence is where a person (and its employees and directors) is an authorised representative of a licensee. This reflects the approach to licence all principals rather than agents. Because of this approach, the licensee that authorises its representatives must ensure that they are competent to provide the services, and are generally liable for their actions. The approach is based on the premise that the principal conducts the relevant business through its employees and agents and is under a legal obligation to control and supervise the employees or agents.

2.7 ASIC is responsible for enforcing the law when it is breached by a licensee or a person acting on their behalf. This may involve the use of an administrative remedy, such as cancelling a licence or banning an individual from providing financial services.

2.8 ASIC has the power to ban or seek disqualification by a court of persons providing financial services in certain circumstances. ASIC's banning power applies, for example, if the person is convicted of fraud or breaches a financial services law.

2.9 During the *Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services* (PJC Inquiry), ASIC raised concern with its ability to protect investors by restricting or removing from the industry participants who might cause or contribute to investor losses. ASIC consider this issue arises as:

- the threshold for entry into the licensing regime is 'low' while the threshold for cancelling a licence is 'relatively high'; and
- the regime focuses on entities rather than its agents (such as employees or directors) which means ASIC cannot prevent persons from entering the industry and can have difficulty removing them.[1]

2.10 In its submission to the PJC, ASIC noted that its decisions in relation to licensing can be appealed to the Administrative Appeals Tribunal (AAT) and that in practice ASIC has found it very difficult to establish before the AAT that a licensee 'will not' comply with its obligations in the future. More specifically, in relation to considering whether a licence should be granted, ASIC has experienced difficulty when trying to assess whether an applicant 'will not' comply with their obligations and meet their licence conditions before they have commenced business.[2]

2.11 Further, ASIC has noted that it has experienced specific issues in attempting to use its powers to ban persons from providing financial services. ASIC has found it difficult to establish that it has a reasonable belief that the person 'will not' comply with their obligations under financial services law: see *Re Howarth and ASIC* [2008] AATA 278. Specifically, ASIC found it difficult to establish that a broader range of conduct (aside from convictions for fraud) can found a belief that the

1 PJC Inquiry into financial products and services in Australia, Submission by the Australian Securities and Investments Commission, August 2009, 24.

2 Ibid, 26, 31.

individual 'will not' comply with their obligations under financial services law in the future. For example, ASIC has been unable to establish that the following conduct should give rise to a banning order based on a finding under paragraph 920A(1)(f) of the Corporations Act:

- failure to comply with the principal's internal guidelines and procedures;
- failure to comply with the relevant ASX business rules; or
- conduct which may amount to a serious conflict of interest.[3]

2.12 ASIC has also noted that it cannot currently ban individuals on the basis that they are not 'fit and proper' (that is, not competent or of good fame or character).[4]

2.13 ASIC has experienced difficulty in relation to the banning of individuals because of the focus on entities in the Corporations Act. Licensing generally occurs at the entity level and ASIC does not approve the agents or representatives of that entity. Further the obligations in the Corporations Act are largely imposed on the licensee (the entity), not the representatives who work for that entity.[5] For example, the requirement to have a reasonable basis for advice under section 945A of the Corporations Act applies to a providing entity, which includes the licensee and authorised representative. The provision does not directly apply to an employee or director.[6]

2.14 Further to ASIC's experience in using its powers, broader concerns have been raised about the effectiveness of licensees being responsible for the actions of their representatives, with implications for the professionalism of the industry, as well as investor protection. This issue was considered in the PJC Inquiry.[7]

2.15 In light of the above concerns, in its report the PJC recommended that the Corporations Act should be amended to provide extended powers for ASIC to ban people from the financial services industry under section 920A (recommendation 6). The PJC also recommended that ASIC be able to deny a licence application or suspend/ cancel a licence, where there is a reasonable belief that the licensee 'may

3 Ibid, 33.
4 Ibid, 32.
5 Under the Corporations Act, some of the Chapter 7 conduct and disclosure obligations are also imposed on an authorised representative, in addition to the licensee. However obligations are not generally imposed on other representatives, such as employees and directors.
6 Ibid, 26.
7 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, November 2009, 134, paragraph 6.130.

not comply' with its obligations under sections 913B and 915C of the Corporations Act (recommendation 8).[8]

Summary of new law

2.16 The enhancements to ASIC's licensing and banning powers are:

- a change to the licensing threshold so that ASIC can refuse or cancel/suspend a licence where a person is likely to contravene (rather than will breach) its obligations;
- extend the statutory tests so that ASIC can ban a person who is not of good fame and character or not adequately trained or competent to provide financial services (in essence they are not a fit and proper person);
- ensure that ASIC can consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions.
- a change to the banning threshold so that ASIC can ban a person if they are likely to (rather than will) contravene a financial services law; and
- clarification that ASIC can ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.

Comparison of key features of new law and current law

New law	*Current law*
In relation to an ASIC decision to grant a licence, the statutory test under paragraph 913B(1)(b) is whether the applicant is likely to contravene its obligations under section 912A, rather than they will not comply with the obligations.	In relation to an ASIC decision to grant a licence, the statutory test under paragraph 913B(1)(b) is whether the applicant will not comply with its obligations under section 912A.
In relation to ASIC having a reason to believe that the applicant is not of good fame and character under paragraph 913B(4)(a), ASIC must	In relation to ASIC having a reason to believe that the applicant is not of good fame and character under paragraph 913B(4)(a), ASIC must

8 Ibid, 151.

consider any conviction for an offence that involves dishonesty and is punishable by imprisonment for at least three months.	consider any conviction for serious fraud.
In relation to an ASIC decision to suspend or cancel a licence, the statutory test under paragraph 915C(1)(aa) is whether the applicant is likely to contravene its obligations under section 912A, rather than they will not comply with the obligations.	In relation to an ASIC decision to suspend or cancel a licence, the statutory test under paragraph 915C(1)(aa) is whether the applicant will not comply with its obligations under section 912A.
In relation to an ASIC decision to make a banning order against a person, the statutory test under paragraph 920A(1)(ba) is whether the person is likely to contravene its obligations under section 912A, rather than they will not comply with the obligations.	In relation to an ASIC decision to ban a person, the statutory test under paragraph 920A(1)(ba) is whether the person will not comply with its obligations under section 912A.
In relation to an ASIC decision to make a banning order against a person, the new statutory tests under paragraphs 920A(1)(d) and (da) is whether the person is not of good fame and character or that they are not adequately trained or competent to provide financial services. There is no change to existing subsection 920B(2), where the fact that a person is not of good fame and character is relevant to determining the effect of a banning order.	There are no equivalent statutory tests. Under existing subsection 920B(2) the fact that a person is not of good fame and character can only be taken into account to determine the effect of a banning order.
In relation to an ASIC decision to make a banning order against a person, the statutory test under paragraph 920A(1)(f) is whether the person is likely to contravene a financial services law rather than they will not comply with the law.	In relation to an ASIC decision to ban a person, the statutory test under paragraph 920A(1)(f) is whether the person will not comply with a financial services law.
In relation to an ASIC decision to ban a person, the statutory test under paragraphs 920A(1)(g) and (h) is whether the person has been involved, or is likely to be involved, in a contravention of a financial services law.	There is no equivalent statutory test.

Detailed explanation of new law

2.17 The Bill amends ASIC's licensing and banning powers to clarify the operation of its powers, as well as prescribe additional tests under which ASIC can remove persons from the industry. The amendments enhance ASIC's ability to supervise the financial services industry to protect consumers of financial services.

2.18 The changes to ASIC's powers remain subject to the broader principles of administrative law that would underpin the exercise of its powers. This includes that the decision must be within its power, and that only relevant considerations must be taken into account. Further, the exercise of ASIC's powers must be for a proper purpose and not in bad faith, with facts based on sufficient evidence, and any decision taken by ASIC must be reasonable and with procedural fairness afforded.

2.19 While administrative action by ASIC would be taken on the individual circumstances of each case, action would generally take account of things like the nature and seriousness of the misconduct, the internal controls on the licensee or the person and the previous regulatory record of the licensee or person.

2.20 Existing review rights in relation to ASIC decisions about licensing and banning continue to apply, including to the AAT.

Amendments to ASIC's licensing power

2.21 The Bill amends the operation of ASIC's licensing power to clarify that ASIC is not required to believe as a matter of certainty that the person will contravene the obligations in future.

2.22 ASIC can refuse to grant a licence if the statutory test under existing paragraph 913B(1)(b) is satisfied. The amendment to the statutory test is whether the applicant is likely to contravene its obligations as a licensee under section 912A, rather than they will contravene the obligations (that is, the applicant will not comply with the obligations). In the 10 years since the introduction of the Financial Services Reform Act, interpretation of this provision has tended to a view that ASIC is required to believe, as a matter of certainty, that the person will contravene the obligations in future. Such a standard would be so onerous that it could result, in practice, in ASIC never being able to refuse a licence using this part of the test. This new formulation is designed to ensure that ASIC can more appropriately account for the likelihood or probability of a future contravention. ***[Schedule 1, item 2, paragraph 913B(1)(b)]***

2.23 The statutory test is whether the applicant is likely to contravene the obligations under section 912A. ASIC may take into account any information relevant to this question, such as:

- conduct of the applicant that shows deliberation and planning in wilfully disregarding the law;

- the extent of compliance by the applicant with analogous obligations in another regime; or
- any other conduct of the applicant that may lead ASIC to conclude, on reasonable grounds, that the applicant is not likely to comply.

2.24 The same amendment is also made to the statutory test under paragraph 915C(1)(aa) of the Corporations Act, which relates to an ASIC decision to suspend or cancel a licence. The amendment to the statutory test is whether a licensee is likely to contravene the obligations under section 912A, rather than they will contravene the obligations (that is, the licensee will not comply with the obligations). Similar to the amendment in paragraph 2.22, the amendment addresses interpretation of this provision which has tended to a view that ASIC is required to believe, as a matter of certainty, that the person will contravene the obligations in future. ***[Schedule 1, item 4, paragraph 915C(1)(aa)]***

2.25 ASIC must grant a licence unless it has no 'reason to believe' that the applicant is likely to contravene the obligations or other factors in subsection 913B(1) apply. There is no change to the 'reason to believe' element of the test in relation to the granting or suspension/cancellation of a licence, which requires actual evidence that the person was involved in wrongdoing rather than just mere suspicion.

2.26 Clarification is also provided on the matters ASIC must consider in having a reason to believe that the applicant is not of good fame and character for the purposes of licensing decisions. The amendment is ASIC must consider any conviction of a person for an offence that involves dishonesty (within 10 years before the application was made) that is punishable by imprisonment for at least three months. ***[Schedule 1, item 3, paragraph 913B(4)(a)]*** While ASIC must also consider any other relevant matter under existing paragraph 913B(4)(d), the amendment clarifies that ASIC must have regard to offences of dishonesty, which would include fraud. This approach is consistent with existing arrangements under subparagraph 206B(1)(b)(ii) of the Corporations Act, where a person is disqualified from managing corporations if they are convicted of an offence that involves dishonesty and is punishable by imprisonment for at least three months.

2.27 There is no policy change relating to the replacement of 'comply' with 'contravene' in both amendments. It brings consistency with similar provisions ASIC also administers under the *National Consumer Credit Protection Act 2009.* ***[Schedule 1, items 2 and 4, paragraphs 913B(1)(b)] and 915C(1)(aa)]***

Amendments to ASIC's banning powers

2.28 The Bill clarifies the operation of ASIC's banning power and sets out new tests under which ASIC can exercise its discretion to remove persons from the financial services industry.

Clarifications to banning power

2.29 ASIC may ban a person if either statutory tests under paragraphs 920A(1)(ba) and 920A(1)(f) of the Corporations Act are satisfied.

2.30 The amendment to the statutory tests is whether the person is likely to contravene its obligations under section 912A or financial services law, rather than they will contravene the obligations (that is, the person will not comply with its obligations or financial services law). In the 10 years since the introduction of the Financial Services Reform Act, interpretation of this provision has tended to a view that ASIC is required to believe, as a matter of certainty, that the person will contravene the obligations in future. Such a standard would be so onerous that it could result, in practice, in ASIC never being able to ban a person using these tests. This new formulation is designed to ensure that ASIC can more appropriately account for the likelihood or probability of a future contravention. ***[Schedule 1, items 5 and 7, paragraphs 920A(1)(ba) and 920A(1)(f)]***

2.31 There is no policy change relating to the replacement of 'comply' with 'contravene' in both amendments. It brings consistency with similar provisions ASIC also administers under the *National Consumer Credit Protection Act 2009.* ***[Schedule 1, items 5 and 7, paragraphs 920A(1)(ba) and 920A(1)(f)]***

New statutory tests and other clarifications

2.32 The Bill includes new tests for when ASIC can make a banning order against a person. The tests relate to a person's fame and character and competence. In essence, this introduces a 'fit and proper' test however the limbs of good fame and character and competence are adopted for consistency with the rest of the Corporations Act which uses the good fame and character test.

2.33 ASIC can ban a person if their conduct gives ASIC reason to believe they are not of good fame and character. ***[Schedule 1, item 6, paragraph 920A(1)(d)]*** In determining whether a person is not of good fame and character ASIC must take into account (subject to Part VIIC of the Crimes Act relating to spent convictions):

- any conviction of the person, within 10 years before that time, for an offence that involves dishonesty and is punishable by imprisonment for at least three months; and
- whether the person has held a licence that was suspended or cancelled; and

- whether a banning order or disqualification order under Division 8 has previously been made against the person; and
- any other matter ASIC considers relevant. ***[Schedule 1, item 9, paragraph 920A(1)(1A]***

2.34 The factors that ASIC must take into account in considering whether a person is not of good fame and character is consistent with the factors used in its decisions on licensing.

2.35 Given that it can be expected that ASIC will principally use this power to ban individuals, this would enable ASIC to take into account conduct such as where:

- ASIC believes the individual has committed a fraud, but the individual has not been prosecuted or there is a delay or uncertainty in prosecution;
- the individual has engaged in conduct causing serious detriment or financial loss to consumers, so that there is a need to protect the public;
- the individual has been subject to adverse findings in relevant criminal or civil proceedings, reflecting on their character;
- the individual has demonstrated a consistent failure to comply with the law, or with directions from any licensee or employer; or
- the individual has been a director or senior manager of a licensee that has had its licence suspended or cancelled.

2.36 Further, the amendment also introduces a statutory test that ASIC can ban a person if their conduct gives ASIC reason to believe they are not adequately trained or competent to provide financial services. ***[Schedule 1, item 6, paragraph 920A(1)(da)]*** It is expected that ASIC will principally use this power to ban individuals where the person lacks appropriate skills, knowledge and experience to provide financial services.

2.37 The Bill also clarifies ASIC's ability to ban individuals, given the focus of obligations on the entity or licensee. The Bill extends the grounds of banning to whether the person is involved in (or likely to be involved in) a contravention of a financial services law, which enables ASIC to take into account conduct where the person is not under a legal responsibility to comply with the legislation themselves but they contributed or caused another person to breach the legislation. Where the licensee is, for example a body corporate, then any contravention of the law will necessarily be the result of an act or omission of a natural person, such as a director or employee. The amendments clarify that ASIC can take into account conduct of these persons where they have been involved in a contravention of the financial services law, in deciding whether or not these individuals should be banned. The amendment also applies in circumstances where the licensee is a natural person, but an employee of the licensee was involved in a contravention of the licensee's obligations under law. ***[Schedule 1, item 8, paragraphs 920A(1)(g) and (h)]***

2.38 Under existing section 79 of the Corporations Act, a person is 'involved in' a contravention of a financial services law if the person:

- has aided, abetted, counselled or procured the contravention; or
- has been induced, whether by threats or promises or otherwise, the contravention; or
- has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
- has conspired with others to effect the contravention.

2.39 To avoid doubt, the Bill also clarifies that a person contravenes a financial services law if a person fails to with comply with the duty, even if the provisions which impose the duty is not an offence or civil penalty provision. ***[Schedule 1, item 9, paragraph 920A(1)(1B]***

Application and transitional provisions

2.40 The amendments commence on 1 July 2012, noting it is possible that in the exercise of these powers ASIC may take into account conduct that occurred before the commencement date. However the purpose of the provisions is to prevent unsuitable people from providing financial services to protect the public. ***[Item 2]***

Chapter 3
Regulation impact statement

Background and problem identification

3.1 This Regulation Impact Statement represents certain policies announced by the Government in April 2010. Further related policy was developed and announced by Government in April 2011.

3.2 The *Corporations Act 2001* (the Corporations Act) regulates financial products and services in Australia. One way in which an investor acquires a financial product is as a result of following financial product advice. There are relevant conduct rules around the giving of financial product advice and rules to ensure participants behave fairly and honestly. There are also disclosure requirements designed to overcome information asymmetry between industry participants and investors where disclosure assists investors to make informed decisions.

3.3 Currently, the Corporations Act requires that conflicts of interest be managed and disclosed. The law requires that fees or remuneration (including commissions and other payments) are disclosed clearly to retail investors. It does not set limits on what can be charged or how it can be charged. The Corporations Act also requires that advisers have a reasonable basis for financial product personal advice (that is the advice must be suitable). Under equitable principles, there are some duties owed by persons providing advice to their clients arising out of the adviser/client relationship. However, there is a lack of clarity around when those duties apply and precisely what is required to comply with them.

3.4 Under the Corporations Act, generally before the financial service is provided, a retail client must be provided with a Financial Services Guide (FSG) that contains information about remuneration, including commissions or other benefits to be received by an adviser. If personal advice is provided, the retail client also generally receives a Statement of Advice (SOA) from an adviser which includes information about the advice and remuneration and commissions that might reasonably influence the adviser in providing advice. Before a product is provided, a retail client must further receive a Product Disclosure Statement which must also include information about the cost of the product and information about commissions or other payments that may impact on returns.

Retail investments

3.5 Retail investors hold a variety of financial products. In the main this includes superannuation, life insurance, deposit products, shares, debt securities (including debentures) and managed funds (other than superannuation). The total value of household investment in these investment products is around $350 billion or 5.5 per cent of total household wealth.[9]

3.6 Retail investors can purchase products in different ways. This includes products:

- distributed without advice, that is directly from a product provider or third party broker or dealer;
- distributed with some advice, but not by a financial planner[10] (that is, representative of the product provider who provides some general or personal advice about the product); and
- distributed by a financial planner who provides personal advice to retail clients. The planner may or may not be associated with a product provider but is likely to receive commissions from them. Financial planners also may use platforms[11] to invest in financial products on behalf of clients.

Fees

3.7 Investors pay fees when they acquire financial products. In some circumstances, and generally for managed funds, investors tend to pay the same total in product fees whether the product is distributed through a financial planner or not.

3.8 An investor purchasing a managed fund will generally make a substantial initial investment in the fund, and may well make additional contributions. Fees are then deducted from this investment, including entry and contribution fees, administration/account fees, transaction fees

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9 Australian Bureau of Statistics, Cat No 5204, Australian System of National Accounts, 2007-08. Household investment in debt securities at 30 June 2008 was $11.9 billion or 0.2 per cent of total household assets. The ABS data do not provide information on specific investments in shares and managed funds other than superannuation. However, the total amount of wealth invested in shares and other equity, including investment in shares and managed funds other than superannuation, at 30 June 2008, was $338.6 billion, or 5.4 per cent of total household assets. (ASIC's Submission to PJC, August 2009, 101).

10 There is no legislative definition of the term financial planner.

11 A platform is an administration facility that simplifies acquisition and management of a portfolio of investments. Platforms allow retail investors to purchase a range of investments through the one facility. In one sense platforms are like a department store where you can choose from different brand names and products in the one place, rather than having to visit a number of specialty stores.

and fund management fees (investment and performance fees). Fees are generally set by the product manufacturer and built into the product.

3.9 Each financial service provider receives a payment from the product fees the investor pays. That is:

- the product provider pays its fund manager fees for managing the investment; and
- where there is a financial planner, the planner and dealer group are also paid for advice/sale of the product;
- the product provider may pay a commission for the sale of the product, generally to the dealer group. The dealer group then passes on part of the commission to an individual planner. Where there is an employee adviser, they may not receive part of the commission but rather a salary. However often the sale counts towards sales targets that may earn the planner a bonus; and
- the dealer group or planner is paid an ongoing commission (trail commission) and this is paid out of administration fees from the retail investor's account.[12]

Financial Planning Industry

3.10 Financial advice comes from many sources including financial planners, brokers and accountants.[13]

3.11 In the Australian market, there are 700-1,000 adviser dealer groups operating more than 8,000 financial planning practices and employing around 18,200 people. Industry revenue for the 2008-09 financial year is expected to be $4.36 billion, an estimated fall of 18.1 per cent compared with 2007-08. The average financial planner has 380 clients, of whom 40 per cent are advised regularly and on a face-to-face basis.[14]

3.12 Approximately 85 per cent of advisers are associated with a product provider. Of the remainder, the vast majority receive commissions from product providers.[15]

12 ASIC Submission to the PJC Inquiry, August 2009, 107-8.
13 There are some differences between the common usage of the term 'financial planner' and legal concept of 'provider for financial product advice'. A broad range of people may provide 'financial product advice'. The data under 'financial planning industry' relates to the industry as the term is more commonly understood.
14 ASIC submission to the PJC Inquiry on Financial Products and Services in Australia, 109, per Rainmaker, Financial Planning. Rainmaker considers there are 749 advisory groups. The above figure reflects alternative estimates.
15 Ibid, 110.

Remuneration models

3.13 Financial planners receive a mix of salaries, 'fee for services', bonuses and commissions. The Financial Planning Association (FPA) identified the most common remuneration types to be hourly rate/time based charging; service based charging; asset based charging; commission and subsidised advice.

3.14 Many planners tend to charge zero or minimal advice fees and instead receive their remuneration from product providers. Product providers recover these charges from the charges levied within products.

3.15 Trailing commissions (usually 0.6 per cent of account balances) are the main remuneration method for financial planners, with seven in ten planners citing them as a form of remuneration. Other forms of remuneration include initial commission on new investment/contribution (up to 4-5 per cent of contributions), volume bonuses (that is, additional commission of up to 0.25 per cent of account balances), and fee for service charged to the client (up to 1 per cent of account balance, or a flat fee, perhaps related to the hours involved). These amounts would not all be paid at the maximum level.

3.16 Trailing commissions are more common among aligned independent and aligned planners,[16] while bank-based planners favour up-front commissions.

3.17 Remuneration models vary across organisations and according to the market segment to which a client belongs. Low to mid-wealth clients tend to pay initial and trail commissions, while 'high net worth' and 'affluent' clients tend to pay a greater proportion of service fees as a percentage of assets invested, or flat dollar adviser fees. This is most likely because wealthy clients are more sophisticated about how much the advice is costing, and more able to negotiate fees than less-wealthy clients. Wealthy clients tend to receive sophisticated treatment and periodic reviews from their advisers, while smaller customers tend to be offered simple strategies, packaged products and one-off sales. Again, this segmentation is likely based on both customers' needs and ability to pay.

3.18 Revenue from fixed-rate and hourly-rate fee for service was 16 per cent of total planner revenue in 2008. Independent planners have a

16 An aligned planner is a planner who works for a financial planning firm, which is owned by a product manufacturer. That is, the licensee/dealer group and the planners within are aligned to the product manufacturer (AMP Financial Planning is an example). An aligned independent is an employee of a financial planning firm, which is owned by a product manufacturer but the firm is independently branded (for example, Hillross (owned by AMP)). The independence refers to the level of influence the product manufacturer has over the planners within the firm regarding what they sell/advise on and who owns the clients.

higher proportion of fee for service arrangements than bank planners, with around 13 per cent of independent planners deriving over half of their revenue from pure fee for service in 2008, compared to 6 per cent of aligned planners and 1 per cent of bank planners. Forty eight per cent of bank planners did not derive any revenue from pure ‘fee for service’ in 2008 (and 9 per cent of all practices).

3.19 Planners deriving most of their revenue from pure fee for service spend almost half (47 per cent) of their time with clients planning for financial and lifestyle goals, and put less of their client portfolios into managed funds and more into direct equities. Planners deriving no revenue from pure for fee service were more risk-oriented.[17]

3.20 Advisers derive revenue from:

- trail commissions (per cent of assets) (estimated at 35 per cent of adviser revenue);
- initial or up-front commission (per cent of initial investment) (estimated at 26 per cent of adviser revenue);
- fee for service as a per cent of assets under management (called an asset based fee) (estimated at 23per cent of adviser revenue); and
- fee for service as a fixed dollar amount or an hourly rate paid up-front or out of the product (estimated at 16 per cent of adviser revenue).[18]

Access to advice

3.21 Not all investors obtain financial advice. Available figures indicated that between 22 per cent and 34 per cent of adult Australians access financial advice. Use of a financial adviser increases with age.[19]

CONFLICTS OF INTEREST

3.22 Remuneration structures in the financial services industry must be disclosed as they can create real and potential conflicts of interest that may distort the quality of advice. While all remuneration structures may create some form of conflict, there is some evidence that certain structures are creating strong conflicts which are not being sufficiently addressed through current regulation that requires conflicts to be managed and disclosed.

17 Ibid, 110-11.
18 ASIC submission to the PJC Inquiry on Financial Products and Services in Australia, 48-49 per Investment Trends October 2008 Planner Business Model Report, 27.
19 Ibid, 114.

3.23 Problems have been identified with commission-based remuneration arrangements, sales and volume incentives and the use of asset based fees. The issues are outlined below.

Commission based remuneration arrangements — product provider influence over adviser recommendations

3.24 Typically a commission is an arrangement between a product provider and the adviser or the adviser's licensee and is built into a financial product.

3.25 Upfront and ongoing (trail) commissions paid from product providers to licensees are built into product charges (for example entry and administration fees). For ease of reference, commissions also refer to other product provider payments, including those based on volume or funds under management (other than soft-dollar benefits)[20], as these are payments that come from product providers and may also influence adviser recommendations.

3.26 Where commissions are used, the income of a financial advice business is linked to which products are recommended (for example, industry superannuation funds do not pay commissions, whereas retail superannuation funds do). Advisers earn income according to the type and volume of products sold. There are many incentives to meet volume-based or sales-driven targets.

3.27 Commissions may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interest of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.

3.28 There is some evidence that these conflicts affect the quality of advice. The 2006 Shadow Shopping exercise of the Australian Securities and Investments Commission (ASIC) found that advice that was clearly or probably non-compliant was around six times more common where the adviser had an actual conflict of interest over remuneration. The conflict may lead to advice that is not compliant and not in the client's interests. There is anecdotal evidence that high commissions motivated the mis-selling of Westpoint products.

3.29 In its 2009 report on Financial Products and Services in Australia[21], the Parliamentary Joint Committee (PJC) noted that the ineffectiveness of current disclosure of conflicts and conduct rules that

20 A soft-dollar benefit is a benefit received by a financial adviser (or its associates) other than a basic cash or direct client fee. Examples include subsidised business equipment and luxury overseas conferences.

21 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services into Australia, November 2009.

allow an adviser to favour their own interests over the interests of clients is more likely to lead to sub-optimal investment strategies or excessive fee arrangements than catastrophic outcomes for investors.

3.30 The issue of conflicted remuneration structures has been debated for many years. It more broadly reflects the ongoing debate about the sales focus of the financial advice industry and mismatch with consumer expectations about receiving a professional unbiased advice service.

3.31 In its report, the PJC noted it received considerable evidence suggesting that the most effective way to improve the quality of financial advice for consumers is to remove conflicts altogether by banning commissions and other conflicted remuneration practices. The PJC recommended, among other things, that the Government consult and support industry in developing the most appropriate mechanisms to cease payments from product providers to financial advisers.[22]

3.32 The significance of this issue has been recognised both locally and internationally. Locally, important industry associations, including the Financial Planning Association (FPA) and Investment and Financial Services Association (IFSA), have adopted policies to transition away from commission-based payments. The United Kingdom's Financial Services Authority (FSA) is introducing 'Adviser Charging' which will remove commission bias from advice on retail investment products. The United States Treasury is proposing to give the Securities and Exchange Commission (SEC) the power to examine and ban forms of compensation that encourage intermediaries to put investors into products that are profitable to them, but are not in the investors' best interest.

3.33 Although not conflict related, other issues arise with commissions. After the investor has invested in the product, they cannot control the commission payments to advisers unless they leave the product or nominate another adviser (who receives the ongoing commission payments). Also, ongoing commissions are often paid even if no ongoing advice is being received (only around 40 per cent are clients are advised regularly and on a face-to-face basis). There are also clear transparency issues where investors may not know what they pay for advice or what service they are entitled to in relation to the payment of ongoing commissions.

Other volume based and sales incentives

3.34 A variety of payments throughout the financial services industry are based on volume or sales targets. Some volume based payments are noted above, as they are payments from product providers. However, there are other volume based payments in the financial services value

22 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into Financial Products and Services into Australia, November 2009.

chain that do not flow directly from a product provider, for example that flow to and from platforms (in the form of shelf fees), as well as incentives provided by licensees to its employees or authorised representatives to meet sales or volume targets.

3.35 In relation to platforms[23], there are ongoing payments from platforms to licensees based on volume (relating to funds under management), which also may create conflicts and distort advice. This payment could be characterised as a commission in another guise. There are also Fund Manager Payments, which are ongoing payments that are volume based from the fund manager to the platform. These fees are interrelated, where generally the fund manager pays the platform to sit on the investment menu and the platform pays the licensee to be on the approved product list and the licensee pays the planner for the recommendation of the platform.

3.36 In relation to adviser employees, the very nature of volume based payments and sales incentives encourages the sale of products, rather than the giving of unbiased advice. The indirect conflicts through employee remuneration operate in a similar fashion to conflicts in product provider set remuneration. While it is noted that many employee remuneration bonus arrangements are supplemented by other criteria, such as quality and compliance, often sales targets in some shape or form are the primary determinant of the bonus. Licensees may indicate that quality advice or compliance requirements appropriately manage the conflicts created by sales incentives, so that planners who fall short of required compliance standards will not be eligible for a bonus. However, there are concerns about the effectiveness of these controls in some circumstances and sometimes there will be enormous pressure internally to allow the planner to receive a bonus, notwithstanding shortfalls in terms of compliance.

Asset based fees

3.37 An asset based fee is a fee agreed between a client and adviser. The fee is calculated as a percentage of funds under management. The fee changes with any changes to funds under management.

- Given the transition away from commission based arrangements, there is an expectation that advisers will more heavily rely on the use of asset based fees for remuneration.

23 A platform is an administration facility that simplifies acquisition and management of a portfolio of investments. Platforms allow retail investors to purchase a range of investments through the one facility. In one sense platforms are like a department store where a customer can choose from different brand names and products in the one place, rather than having to visit a number of specialty stores.

3.38 Asset based fees can also create conflicts of interest that can distort the quality of advice. It is important to note that the conflicts related to commissions and asset based fees are different in origin but can present the same type of issues.

3.39 Advisers who are remunerated by the quantity of funds under management can also have conflicts of interest. They have more of an interest in selling investment products to their clients and encouraging their clients to borrow to invest, or use other strategies to maximise funds under management (such as recommending that a client sell other assets, such as real estate and/or property, to invest in products that will expand available funds under management). The conflicts arise most notably where leverage is recommended or where leverage is included in the product.

Storm and asset based fees

3.40 The recent collapse of Storm Financial received close attention by the PJC.

3.41 Storm's remuneration model involved the use of asset based fees and commissions. For geared clients, Storm had a fee for service model (plus trail commissions) equating to roughly 7.5 per cent on all new money invested by clients. This covered the initial advice and ongoing regular servicing of the portfolio. Any additional money invested by the client also attracted this upfront fee for service. Also the product manufacturers would pay Storm annual trail commissions of between 0.2 per cent and 0.385 per cent on the value of that client's investment at the time (including the margin loan).

3.42 Under the Storm model, the fact that fees were generated based on the amount of funds invested and the amount of funds under management created an inevitable conflict of interest between the adviser/licensee's interests in increasing revenue on the one hand and the interests of the client in receiving appropriate advice. Asset based fees create a conflict of interest that encourages advisers to recommend aggressive gearing to increase the upfront fee generated when the borrowed money is invested and to increase the balance of funds under management and thereby the ongoing fees generated. It also acts as a disincentive for advisers to build into the client's strategy an exit plan whereby investors can realise gains as a result of market increases to reduce overall debt, as this would reduce the fees earned by the adviser and licensee.

3.43 In addition, in the case of Storm the overall financial viability of the licensee relied heavily on these asset based fees, which meant that when the global financial crisis occurred, and the value of the clients funds dropped, and clients also stopped investing new monies, the income of the licensee effectively disappeared. By relying on bull market inflows for revenue, Storm was highly susceptible to collapse.

3.44 ASIC noted in its PJC submission that 'Storm may be an example of the potential impact on clients of failure to manage conflicts of interest created by commissions and remuneration based on funds under advice'.

3.45 There are also transparency concerns with the use of asset based fees. The fee can mask the cost of advice, both up-front and in the case of ongoing fees — where the fee rises with normal asset appreciation. There may or may not be a higher level of service when the fee rises due to greater funds under management. This reflects the potential for ongoing fees that do not match the service provided.

Objectives of Government action

3.46 The objective of Government is to:

- minimise or eliminate the use of remuneration practices that distort the quality of advice and adversely affect consumer outcomes;
- encourage the provision of professional unbiased financial advice;
- enable consumers to understand the fees they are paying for advice and the services that they are paying for; and
- facilitate better market outcomes.

Options that may achieve objective(s)

Option A: Status Quo (including simplified fee disclosure)

3.47 This option would maintain the status quo. Current obligations for licensees to manage and disclose conflicts of interest (including remuneration and other payments) would continue. Various disclosure documents would continue to be provided to investors, designed to assist them to understand the potential impact of remuneration based and other conflicts on the advice they receive from financial advisers.

3.48 The Government has already committed to shortening lengthy, complex and unreadable financial services disclosure documentation. Based on current government action to simplify disclosure of financial products and services (which is currently underway), the option would also involve simplified one or two page fee disclosure in the short PDS, supplemented by additional detailed information made available via incorporation by reference (IBR). The disclosure about advice fees is achieved through summary information in the short PDS and more detail provided in the Financial Services Guide (FSG) and the Statement of Advice (SOA).

3.49 This option would see more effective disclosure of financial advice services offered to investors. This includes simplified fee disclosure such that consumers are able to understand the remuneration costs, separate product and advice fees and that those costs are comparable and clear.

Option B: Prospective legislative ban on conflicted remuneration structures. Introduction of new adviser charging rules

3.50 This option would involve a direct ban on conflicted remuneration structures for new contracts (that is, existing contracts are grandfathered such that the ban does not apply to them) from 1 July 2012. As a consequence of the ban on conflicted remuneration structures, the option would also introduce new rules on adviser charging. This includes:

Removing product provider influence over adviser recommendations

3.51 Ban any form of commission from any financial services business in relation to the distribution and provision of advice for retail financial products (excluding risk insurance).

- It would allow adviser charges to be deducted from a client's investments.

3.52 Product providers must distinguish the cost of the product from advice.

Removing the influence of sales incentives and/or other volume based payment

3.53 This would prevent payments throughout the financial services industry that are based on volume or sales targets in relation to the distribution and provision of advice for retail financial products (excluding risk insurance).

Removing adviser incentives to sell and gear clients — ban on the use of asset based fee

3.54 This would prevent an adviser from charging an asset based fee in relation to services provided to a retail client where the adviser recommends their clients borrow to invest or leverage is included in the product (an asset based fee is a fee calculated based on a percentage of funds under management). For example, where a client is advised to borrow funds to invest the adviser would be prohibited from charging an asset-based fee based on both the original equity and the additional leverage.

Introduction of adviser charging rules

3.55 This would require advisers 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. Ongoing adviser charges could also only be levied if it relates to the provision of an ongoing service, which clients must renew annually, or if a payment plan is agreed up-front for advice.

Option C: Industry led action to address conflicted remuneration structures, with Government support

3.56 In Australia, there have been some recent moves to adopt fee for service models instead of commission based payments. While views are not unified across industry, the Financial Planning Association (FPA) and the Investment and Financial Services Association (IFSA) have led action in this regard. Some product providers and/or financial advice firms have, or are in the process of, transitioning away from commission based payments. This includes some of the larger adviser groups.

3.57 This option would involve government and industry developing the most appropriate mechanism to address conflicted remuneration structures. This option was supported by the PJC, although the PJC recommendation involved the government consulting with and supporting industry to develop an appropriate mechanism to cease payments from product providers to financial advisers (that is, this would not cover, for example, asset based fees or employee sales incentives from the licensee).

Option D: Introduce a statutory duty to prefer the client's interests over the interests of the advisor (Client first rule)

3.58 Under this option, a new statutory duty would prohibit advisers, in the event of a conflict, to prefer their own interests over those of the client. This option would clarify for all parties that in no circumstances is it permissible for advisers to put their own interests ahead of those of their client. There would be no possibility of avoiding that duty through disclosure or by obtaining consent of clients to breach it.

3.59 The proposed duty recognises that conflicts do exist in many cases, but will require that advisers ensure that they do not prefer their own interests over those of their clients, thereby compromising the quality of advice. The duty would overlay the existing duties of disclosure and giving appropriate advice. Breaches would be enforceable by clients and the regulator in the same manner as the existing duties and would include civil (including compensation claims) and criminal action, and action by the regulator regarding the financial services licence.

Option E: Introduce a rule banning advisers who have a conflict of interest from providing advice (No conflicts rule)

3.60 Under this option, advisers would be prohibited from providing financial advice in the event that they had a conflict of interest that might compromise the quality of the advice. There would be no possibility of avoiding that rule through disclosure or obtaining the consent of clients to breach it.

3.61 The proposed rule would prohibit all conflicts of interest. It would overlay the existing duties of disclosure and giving appropriate advice. Breaches would be enforceable by clients and the regulator in the same manner as the existing duties and would include civil (including compensation claims) and criminal action, and action by the regulator regarding the financial services licence.

Option F: Introduce a fiduciary-like statutory duty to act in the best interests of clients, subject to a 'reasonable steps' qualification and to place client's best interests ahead of their own

3.62 Under this option, advisers must act in the best interests of their clients and must place the best interests of their clients ahead of their own when providing personal advice. Advisers must already provide advice that is appropriate. Overall, this is supplemented by a requirement that advisers act in the client's best interest in giving personal advice.

3.63 The duty will include a 'reasonable steps' qualification, so that advisers 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. If an adviser cannot recommend a product that is in the best interests of the client from their own 'approved product list' (APL) (a list of products that their licensee has authorised them to sell), then the duty may require them to search beyond the APL or recommend that the client should see another adviser. There would be no possibility of avoiding that duty through disclosure or by obtaining consent of clients to breach it.

3.64 Breaches would be enforceable by clients and the regulator in the same manner as the existing duties and would include civil (including compensation claims) and criminal action, and action by the regulator regarding the financial services licence.

Impact analysis

Option A: Status Quo (including simplified fee disclosure)

3.65 This option would preserve the status quo. Conduct and disclosure rules would continue to regulate conflicts of interest, which is that conflicts of interest must be managed and disclosed.

3.66 This means that fees or remuneration (including commissions and other payments) must be disclosed clearly to retail investors and there would be no limits on what can be charged or how it can be charged. The requirement that advisers have a reasonable basis for financial product personal advice (that is the advice must be suitable) would continue to operate as is.

3.67 Current government work also means that this option would involve the simplification of information provided to consumers on fees and commissions in disclosure documents, such as Product Disclosure

Statements (PDSs) and Financial Services Guides (FSGs). It involves developing 'short form' disclosure documents in an attempt to summarise and simplify complex fee information for consumers in a way that is meaningful to them, with further detail available using Incorporation by Reference (IBR) mechanisms.

3.68 The benefit of this option is that it facilitates choice of remuneration which suits the client and particular adviser. Consumers may also benefit from more understandable fee disclosure. Further market forces may continue to drive a transition to a fee for service environment for adviser remuneration to reflect broader community concerns. The approach is also consistent with existing regulatory measures which to some extent does minimise the compliance burden for industry. There would be no substantive compliance burden on industry, other than a broad impact that, in some circumstances, consumers may continue to not seek financial advice based on the perception of conflicts (noting that consumers may not seek advice for a variety of different reasons). A NewsPoll/Industry Super Network survey in February 2010 indicated that most respondents would prefer a fee-for-service model. 79 per cent of those surveyed believed commissions and other inducements compromised the quality of advice received.

3.69 While not quantifiable, there are costs to consumers in maintaining the status quo. The costs relate to the continued conflicts of interest and its potential adverse impact on the quality of advice. In general, the level of trust that consumers place in their adviser, and the strength of that conflict, often means they are unable to assess the impact of the conflict on the advice received. Further, the inherent sales versus advice conflict may continue to misalign the interests of the consumer and adviser.

3.70 Further, from a consumer perspective, there are also serious questions about whether complex fee arrangements, in particular the way advice fees can be remunerated through the product provider via commission structures and/or calculated as a percentage of funds under management (FUM), can be communicated in a simple and meaningful manner to consumers. The complexity in which advice fees can be incurred pose a significant challenge to achieving 'simplified fee disclosure'.

3.71 A key objective of simplified fee disclosure is to clearly separate product fees from advice fees. Advice fees, however, can be charged in many different ways, including being deducted from the consumer's account in such a way that the advice may appear to the consumer to be 'free'. Advice fees can also be paid as volume bonuses and soft dollar benefits. Disclosure that includes information on advice fees under current remuneration structures becomes, by its very nature, no longer 'simple'.

3.72 While it is possible that simplified disclosure may improve consumer understanding and engagement, this measure alone may not be sufficient to address the conflicts created by conflicted remuneration structures. The conflicts created are strong and consumers may continue to have difficulty understanding the impact of the remuneration on advice.

	Benefits	Costs
Consumers	Consumers can choose the method by which they pay for advice. Some consumers may benefit from simpler disclosure to enable them to understand the fees they are paying.	There is some evidence that conflicted remuneration structures may lead to advice that is not legally compliant or otherwise comprises the client's interest. This can have a wide range of impacts for the investor ranging from possible catastrophic consequences (noting these are more atypical) to sub-optimal investment outcomes (for example even a small difference in a fund's fees and costs can have a significant impact on long term investment returns). Even with simpler disclosure of remuneration, this may not alone be sufficient to address the conflicts created by conflicted remuneration structures. Simplified disclosure is unlikely to improve the quality of advice; as it will not remove conflicted structures. No changes to current arrangements would permit continued potential for misalignment of the interests of consumers in receiving professional unbiased advice and the interests of the adviser. Consumers may also continue to pay for advice services they do not receive.
Industry	Industry can choose the remuneration methods which suits them and their clients.	In relation to simplified disclosure, there would be some minimal compliance impact on product providers, platform providers, licensees and advisers. This would involve one-off compliance costs in adapting new disclosure requirements (for example, structuring and amendments to existing documents). However given a reasonable transitional period, these costs would be relatively minor (and part of normal business costs) given that disclosure documents must be renewed after a certain period. Potential for 'first mover disadvantage' — that is those who have adopted fee for service arrangements may face some competitive disadvantage (it is a highly competitive market for experienced advisers and advisers may move to ensure they can continue to receive commissions).
Government		The existence of conflicts may continue to adversely the quality of advice and consumer outcomes.

Option B: Prospective legislative ban on conflicted remuneration structures. Introduction of new adviser charging rules

3.73 This option would involve a direct ban on conflicted remuneration structures, generally in relation to the distribution and provision of advice for retail financial products (excluding risk insurance).

3.74 Retail investors will benefit from this option because it will reduce the incidence of investors being directed to products as a result of incentives offered to advisers, rather than because investment in the products is in the investors' interests. This may reduce instances of sub-optimal advice, may help to prevent and address the rarer instance of major failures affected by high commissions and result in an overall improvement in advice quality, particularly product recommendations. Further the changes clearly align the interests of the adviser and client, and may build trust in an industry where some consumers may not seek advice because of the perceived conflicts within the industry.

3.75 There have been suggestions that retail investors will no longer be able to afford advice if commission are removed. Some investors may consider that they can no longer obtain 'free' (that is, commission based) advice, notwithstanding that investors indirectly pay for the advice (for example through product charges) and in some instances these payments may cost them more over the long term. This may be a difficult perception change for these clients and may impact on demand for full advice. However retail investors will not be restricted to having to pay a large fee up-front. The ban on commissions and asset-based fees (where leverage is used) will still allow investors to be able to pay for advice using flexible payment mechanisms, such as adviser charges being deducted from a client's investments over time[24] or through a payment plan.

- The available research, undertaken by Rice Warner Actuaries (Rice Warner) on behalf of Industry Super Network (ISN), suggests that clients receiving full advice are likely to pay the same or less in fees after the change. More so, most clients will see the value of the advice provided, even when the cost is transparent. The research also suggests that clients will assess that they often need simple advice and demand for this need will be met.

3.76 The ban on asset based fees only applies to recommendations that include leverage and where leverage is built into the product. There is some potential for consumer detriment in that it does not address a potential issue where advisers can use other strategies to increase funds

24 This mechanism allows product providers to remit adviser payments but as an administrative facility only.

under management. However under proposed adviser charging rules, there will be requirements for advisers to agree the fee with the client, as well as the adviser making dollar disclosure and only charging an ongoing fee if it relates to ongoing service. This addresses concerns about transparency and clients paying more than the value of the service.

3.77 The ban does not initially apply to risk insurance. Insurance has different features than general investment products. Unlike investments, there are no investment funds from which clients can often draw from to pay for financial advice. Therefore there are concerns about the affordability of advice in a fee for service environment and the potential for under-insurance should be explored in this context. In addition, more work needs to be done at a product level to facilitate a move away from commissions to fees for risk products. Further consultation with stakeholders on these issues will be undertaken before a decision is made about the ban and its application to risk insurance.

3.78 There are costs to the industry to implement this option, and the option will also have broader longer-term implications.

3.79 The option is likely to drive structural reform in the industry. It has implications for the way in which products are distributed and businesses are structured. It is a new model for the industry where fees paid for a product must be transparently distinct from the fees paid for advice. This will alter the financial services industry over the long term. However, the grandfathering of existing contracts means that changes to the industry will be more gradual and will occur over time. The grandfathering of existing contracts means that existing fee arrangements (prior to the commencement of the ban) can continue. For example, this means where a person is already invested in a product (prior to the ban) and the adviser is remunerated by commissions; the product provider can continue to pay the adviser the ongoing trail commission and the adviser can continue to receive it.

3.80 There is an expectation that some persons will exit the industry, as with any major reform. The number of persons who may exit the industry is unknown. It is further expected that there will be consolidation of the industry, with larger institutionally owned dealer groups (licensees) acquiring a number of smaller dealer groups to grow their adviser numbers and achieve economies of scale. While this means there will be fewer participants in the market, it does not necessarily represent a reduction in competition and will drive overall efficiency improvements of financial advisory groups.

- The available research from Rice Warner notes that many full service advisers rely on substantial trail commissions and platform rebates to sustain their businesses and, after the regulatory change, advisers will be compelled to demonstrate the value of their services to retain and attract clients. The research notes that as advice is a growth industry, and coupled with overall efficiency improvements, there is still significant scope for financial planners to maintain and develop viable businesses (even if product provider payments are banned for new business).

3.81 These changes may impact on the demand and supply of advice.

- The available research from Rice Warner suggests that demand will be broadly stable and even though adviser numbers will reduce over time, more efficient delivery models for simple advice and efficiency improvements means that demand will be met.

3.82 It is expected that adviser remuneration, as well as the number of advisers, will reduce over the long term.

- The available research from Rice Warner suggests that adviser remuneration will still increase in real terms, although by significantly less than under the current regulatory environment. The reduction in overall adviser remuneration will be $2.5 billion (in 2009 dollars) in 2024 representing 0.23 per cent of GDP. The report also suggests that adviser numbers will reduce[25] and the characteristics of advisers will change.

3.83 There will be a reasonable change management process for participants adopting the proposals. There will be one-off costs to implement the ban on payments and adviser charging, some additional ongoing compliance costs and costs involved with getting across new regulatory requirements.

- Product providers will need to implement ‘factory gate pricing’ (a UK term for separating the cost of the product from the cost of advice). For investment type products, there are current products in the market which separate product and advice costs, and in those circumstances the system changes required should be less than where the provider has no products of this kind. The extent to which product providers already have these systems is not known. Product providers will also need to put procedures and mechanisms in place so they can comply with the ban and associated requirements, such as remitting adviser service fees from the client’s investment.

25 Rice Warner research estimates there are around 15,400 advisers which will remain broadly stable over the next five years and decline to around 8,600 in 2024.

- The immediate impact for financial planning practices will be to set up alternative cash-flow mechanisms. Currently the value of a financial advice business is calculated on a valuation which is based on the income stream from trail commissions times a multiplier (generally between 1.9 and 2.9). The client book becomes the businesses' primary asset. The valuation on this basis is also used by lenders in providing finance to the business secured against the income stream coming from the trail commissions, so there may be a need for advisers to re-negotiate loan arrangements with their financiers based on some other valuation of the business (for example, good will). It should be noted that grandfathering of existing contracts will mean that remuneration that comes from existing arrangements will largely be unaffected.
- Advisers and its licensees will need to devise and introduce an adviser charging structure and make relevant disclosures (noting there are some current disclosure requirements). They will need to cost their services, articulate what and how they provide their services and demonstrate a clear value proposition to their clients.
- Advisers will need to make substantial changes to its disclosure documentation. There would also be changes required to policy documents and employment contracts and so forth. However, the transitional period would likely allow for documentation to be updated according to normal roll-over schedules, which would reduce the impact by spreading it out and making it a part of normal business practice.
- Financial planning practices will have to renegotiate fees with their clients and set up new payment mechanisms. Advisers will also need to change systems and procedures to adopt the new charging structure and are expected to spend more time with clients explaining the fee structure, to demonstrate the value of advice.
- There may be cost saving with regard to the systems and staff that are currently needed to manage commission payments. This can be a complicated and time-consuming process involving calculating commissions and doing manual 'clawbacks', for example, where the clients exercise a cooling off period and the commissions need to be repaid to the product provider. These systems and staff add extra cost, and would no longer be required, so there is likely to be a cost saving to business in this regard.

- Advisers who will be most impacted will be the businesses that rely substantially on ongoing trail commissions and do not maintain an existing ongoing client relationship. There is no available data on the number of businesses who might fall into this category.
- Advisers will also incur ongoing annual costs in that they must have clients opt-in each year to continue to provide ongoing service.
- Advisers and licensees may need to re-negotiate their fee-sharing arrangements and may need to adjust other elements of the commercial relationship, such as key performance indicators.
- The overall costs depend on the extent to which participants are already structured to adopt this model, for which there is no available data. Some businesses have made these at least some of the changes. The costs to industry have not been quantified, and were not considered in detail in the PJC Inquiry.

	Benefits	**Costs**
Consumers	Consumers will benefit from improved quality of advice that is not distorted by conflicted remuneration structures. Consumers will benefit from an alignment of adviser interests through remuneration practices that support the clients' interests in receiving professional unbiased advice. The removal of conflicted remuneration structures may enhance trust in the industry and encourage some consumers to seek advice. Consumers will benefit from adviser charging that is clear and directly related to the services provided.	Consumers may continue under the apprehension that commission based advice is 'free' advice and they may perceive an increase in the cost of advice. This may impact of some consumers' willingness to seek advice. There may be some compliance costs passed on to consumers.
Industry	The removal of conflicted remuneration structures may improve the level of generalised trust in the industry and encourage some consumers to seek advice. It is an opportunity for industry to develop more efficient adviser delivery models. No first mover disadvantage.	The ban on conflicted remuneration structures will change the way in which products are distributed and businesses are structured. It is a new model for the industry where fees paid for a product must be transparently distinct from the fees paid for advice. This will alter the financial services industry over the long term. However the grandfathering of existing contracts means that changes to the industry will be more gradual. There will be one-off costs to industry (product providers, platforms, licences and advisers) to implement the ban. There will be some ongoing costs to industry, as a result of new rules (such as

		opt-in annual renewal notices). Some businesses are expected to exit the industry.
Government	Consumers will benefit from better quality of advice and outcomes.	

Option C: Industry led action to address conflicted remuneration structures, with Government support

3.84 Option C would build upon existing industry measures to transition away from commission based payments. The Government would work with industry to develop the most appropriate mechanism to cease these payments.

3.85 To date, not all of industry support a transition away from commission based payments. Further the moves by some parts of industry to transition away from commissions are limited in some way. For example, the policies only apply to certain products or to certain types of payments.

3.86 The benefit of this option, is that in some instances, it will benefit consumers by reducing the incidence of investors being directed to products as a result of incentives offered to advisers, rather than because investment in the products is in the investors' interests. This may result in an overall improvement in advice quality, particularly product recommendations.

3.87 However the key limitation of this option is that those benefits will only ensue where the initiatives apply. As the initiatives will not apply to all products and payments that create conflicts, the costs to consumers will continue in those circumstances. Further if certain payments continue (as per current industry initiatives) there is a real risk that removed benefits will flow through those mechanisms and in fact there will no substantive change to current arrangements.

	Benefits	**Costs**
Consumers	Consumers will benefit from improved quality of advice that is not distorted by conflicted remuneration structures, but only to the extent that the initiatives apply. The removal of some conflicted remuneration structures may enhance trust in the industry and encourage some consumers to seek advice. To the extent that the initiatives apply, consumers will benefit from adviser charging that is clear and directly related to the services provided.	To the extent that the initiatives apply, consumers may continue under the apprehension that commission based advice is 'free' advice and they may perceive an increase in the cost of advice. This may impact of some consumers' willingness to seek advice. To the extent that the initiatives apply, there may be some compliance costs passed on to consumers. Where the initiatives do not apply, consumer detriment will continue (as described under costs of maintaining the status quo).

Industry	To the extent that the initiatives apply, the removal of conflicted remuneration structures may improve the level of generalised trust in the industry and encourage some consumers to seek advice. It is an opportunity for industry to develop more efficient adviser delivery models.	To some extent, the initiatives will change the way in which products are distributed and businesses are structured. There will be one-off costs to industry (product providers, platforms, licences and advisers) to implement the relevant initiative. The implications and costs relate solely to the scope of initiatives which have been developed by industry associations or companies.
Government	To the extent that the initiatives apply, consumers will benefit from better quality of advice and outcomes.	The measures are not comprehensive and this allows certain consumer detriment to continue.

Option D: Introduce a fiduciary-like statutory duty to prefer the client's interests over the interests of the advisor (Client first rule)

3.88 Option D will not necessarily ban any particular form of remuneration. The proposed duty is a more generic standard that will address issues that might arise from all types of conflicts — for example, ownership-based conflicts.

3.89 It would be able to operate in connection with future provision of advice connected to an existing arrangement with a client. In contrast, the proposal to ban particular remuneration structures can only operate prospectively, due to constitutional restrictions concerning acquisition of property.

3.90 The rule would benefit consumers by reducing the incidence of advice being compromised through conflicts, resulting in sub-optimal outcomes for consumers of financial advice.

3.91 A further possible result of the proposal for the new duty to place the client's interests first is that it would serve to strengthen, from the perspective of potential enforcement, the existing duties of intermediaries to ensure the advice has a reasonable basis and is appropriate for the client's need. When that test is paired together a statutory duty to place the interests of the client first when there is a conflict, there is a clearer message in the statute about unacceptable conduct which would be of benefit to the regulator in its enforcement efforts.

3.92 For persons conducting the business of financial advice, despite the existing of equitable principles that have similar elements, there would be some transitional costs associated with ensuring that their business structure and practice does not violate the rule. On some occasions on an ongoing basis, the rule would require advisors to, for example, change recommendations to a product that offers less benefits to the advisor in order to ensure the client's interest is preferred over their own.

	Benefits	Costs
Consumers	Consumers will benefit from improved quality of advice that is not distorted by conflicted remuneration structures. Consumers will benefit from an alignment of adviser interests through remuneration practices that support the clients' interests in receiving professional unbiased advice.	There may be some compliance costs passed on to consumers.
Industry	Clarification of the duty may offer some savings in the longer terms as the conduct that is permitted and not permitted is certain.	Transitional costs for some financial advice providers in ensuring that business structures and practices do not violate the client first rule. Lesser ongoing costs resulting from the need to prefer the client's interest over their own. A degree of complication and uncertainty due to the limitation of the duty to circumstances where the client and the adviser's interests are in conflict.
Government	Supplementation of existing rules will clarify required behaviours and assist regulators to enforce requirements against advisors engaging in practices detrimental to consumers.	

Option E: Introduce a rule banning advisers who have a conflict of interest from providing advice (No conflicts rule)

3.93 Option E would effectively prohibit many forms of remuneration currently used. Commission payments would violate the rule. There may also be significant impact on the structure of vertically integrated business (where a product provider owns a financial advice business).

3.94 The benefit of the rule for consumers would be that all advice would be free of any 'skewing' as a result of a conflict. However, a no conflict rule would require large scale restructuring of a large proportion of the financial advice industry. Many market participants are likely to leave the industry, and those that are left would need to operate on a fee for service basis. This would result in some serious risks that access and affordability of advice for most consumers would be detrimentally affected.

3.95 For industry, the majority of participants in the financial advice industry may not be able do business as usual without violating the no-conflict rule and/or that carve outs would be required (for example the position of conflict an employee adviser of the Commonwealth Bank may find themselves in). There would need to be a major shift to a fee for service model and the costs of doing so is likely to result in a significant number of market exits.

3.96 For Government, there are likely to be some costs involved with supporting industry participants (including employees) of advice businesses unwilling or unable to make the transition to a no-conflict environment.

	Benefits	**Costs**
Consumers	Consumers will benefit from improved quality of advice that is not distorted by conflicted remuneration structures or other conflicts. Consumers will benefit from an alignment of adviser interests through remuneration practices that support the clients' interests in receiving professional unbiased advice.	Cost of advice would increase significantly and availability of advice would decrease significantly.
Industry	Clarification of the duty may offer some savings in the longer terms as the conduct that is permitted and not permitted is certain.	Significant transitional costs for some financial advice providers — which in some cases would be high enough to provoke market exit. Ongoing costs resulting from the need to withhold services in cases where conflict exists.
Government		Possible need for government support of exiting advisors.

Option F: Introduce a fiduciary-like statutory duty to act in the best interests of clients, subject to a 'reasonable steps' qualification and to place client's best interests ahead of their own (best interest's formulation)

3.97 Option F may preclude advisers from receiving commission payments in many circumstances but not in all cases. For example, there may be cases where it could be argued that the advisers' interests coincided with those of the client and the commission could be payable in those circumstances.

3.98 The benefit of the rule for consumers is that it encompasses the benefits of the client first rule (option D), including that it reduces the incidence of advice being compromised through conflicts, resulting in sub-optimal outcomes for consumers of financial advice. More generally, consumers will also benefit from advice that is in their best interests, as advice may be compromised by remuneration and other conflicts. The option strengthens the existing duties of intermediaries to ensure the advice has a reasonable basis and is appropriate for the client's need.

3.99 For persons conducting the business of financial advice, despite the existence of equitable principles that have similar elements, there would be transitional costs associated with ensuring that their business structure and practice does not violate the rule. The costs include a review of and/or changes to processes supporting the giving of advice, including product selection, the scope of the approved product lists and training of advisers. It is expected to increase the requirements for research and due diligence before products are approved for sale, as they will need to be in the client's best interest.

- The quantum of these changes, and costs involved, depend on the extent to which businesses are structured to implement the best interest's formulation, which is unknown.

3.100 While Option D requires that in the event of a conflict, an adviser must not prefer their own interests over those of the client, it does not require advisers to act in the client's best interest generally. However Option F has the effect that an adviser must act in the client's best interest. For example, if an adviser cannot recommend a product that is in the best interests of the client from their own 'approved product list' (APL) (a list of products that their licensee has authorised them to sell), then the duty may require them to search beyond the APL or recommend that the client should see another adviser.

- Given this, there would likely be some rationalisation of investment products, including the development of simpler investment products for 'approved product lists' (for example, investment products based on standard age/asset mixes).

3.101 The option does not propose an impractical standard on industry. The duty will include a 'reasonable steps' qualification, so that advisers 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.

3.102 Industry already complies with a best interest test in relation to obligations placed on responsible entities of managed investment schemes. This means that there is already some understanding and application of these principles within the Corporations Law.

The option will provide greater scope to the regulator to address consumer detriment arising from sub-optimal product recommendations.

	Benefits	Costs
Consumers	Consumers will benefit from advice that is in their best interests, including more appropriate product recommendations. Consumers will benefit from advice that is not distorted by conflicts. Potential for development of simpler investment products for retail clients	There may be compliance costs passed to consumers. Particularly in the short tern, the cost of advice may increase.
Industry	Clarification of the duty may offer some savings in the longer terms as the conduct that is permitted and not permitted is certain. It is broadly consistent with other obligations in the Corporations Act. Reasonable care qualification clarifies the scope of the duty, in that it does not impose an impractical standard on advisers to base their recommendations on an assessment of every single product in the market.	Transitional costs for some financial advice providers, including a review and or changes to procedures relating to the giving of personal advice to retail clients. This includes costs for research and due diligence requirements, scope of approved product lists and training requirements for advisers.
Government	Consumers will benefit from better quality of advice and consumer outcomes. The regulator is given greater scope to address consumer detriment.	

Consultation

3.103 The PJC undertook an extensive public consultation process in developing its recommendations. During the inquiry, the PJC received and considered evidence from a broad range of sources, including investors, banks, industry bodies, advisers, product providers, consumer groups, law firms and regulatory bodies. In addition, the PJC conducted public hearings on the issues raised by the PJC.

3.104 Following the PJC inquiry, no further consultation was undertaken by Treasury.

3.105 There will be further consultation with stakeholders on whether the ban on conflicted remuneration structures should apply to risk insurance (including group insurance).

Views on conflicted remuneration structures

3.106 In its report, the PJC noted it received considerable evidence suggesting that the most effective way to improve the quality of financial advice for consumers is to remove conflicts altogether by banning commissions and other conflicted remuneration practices. The PJC recommended, among other things, that the Government consult and support industry in developing the most appropriate mechanisms to cease payments from product providers to financial advisers.

3.107 ASIC recommended, that in addition to banning commissions and other incentives, asset-based fees also be banned, due to the equivalent conflicts. Many other submitters indicated they favoured fee for advice models: ANZ supports fee-for-service arrangements for the provision of holistic advice, the Accounting Professional and Ethical Standards Board consider advisers should adopt fee-for-service models, The Institute of Actuaries of Australia think that commissions should not be payable for advice, and the Institute of Chartered Accountants in Australia consider that advisers should be remunerated based on ‘genuine fee for service arrangements (that is, an asset based fee is not a genuine fee for service), with an industry led solution. The Australian Investors Association (AIA) supports an outright ban on commissions and asset based fees. CHOICE supports a ban on 'remuneration incentives that are inconsistent with fiduciary duties an adviser owes a client'. CHOICE further suggests that ASIC should be given the power to outlaw particular conflicts of interest where it is satisfied that disclosure and management will not prevent inappropriate or biased advice. The Industry Super Network (ISN) recommends a ban on commissions and other forms of conflicted remuneration structures.

3.108 MLC favour a transition to fee for service models, which includes the use of asset based fees but suggest an outright ban on commissions is not appropriate.

3.109 The FPA gave evidence to the PJC that a client directed fee for service model was the most important measure and that asset based fees should be allowed under this model. The FPA stated that asset based fees support the affordability of advice.

3.110 Some do not support a transition away from commission based payments. The Stockbrokers Association of Australia (formerly the Securities and Derivates Industry Association) think disclosure deals with conflicts created by commissions. The Association of Financial Advisers (AFA) and Millenium3 think that consumers and business should be able to choose the remuneration structure that suits them and that the removal of commissions will affect the affordability of comprehensive financial advice. The Commonwealth Bank of Australia (CBA) note that comprehensive advice is expensive and existing subsidies through commissions make it affordable. Further that any regulation should be industry based. APT Strategy argue that banning commissions would ultimately have negative impacts on consumers through increased advice costs. In its evidence to the PJC, the Investment and Financial Services Association (IFSA) noted that removing existing fee structures would increase the cost to consumers.

3.111 The Australian Compliance Institute acknowledge the remuneration based conflicts but consider that alternatives other than fee for service may be required, given concerns about affordability and access to advice.

3.112 Some other submissions from adviser groups also did not support an outright ban on commissions, some arguing that clients should be able to choose remuneration methods and others argued the method of payment for advisers is not important in addressing poor quality/conflicted advice. There were a few submissions that suggest that many planners would go out of business as a result of the changes.

3.113 The submissions did not address the direct implementation costs to industry.

Fiduciary duty

3.114 A number of witnesses appearing before the committee supported the imposition of an explicit fiduciary duty on financial advisers, requiring them to give priority to their clients' interests ahead of their own. ASIC's submission to the PJC inquiry supported a fiduciary like duty.

3.115 Professional Investment Services did not oppose the introduction of a statutory fiduciary duty, indicating that such a duty already exists. The Trustee Corporations Association of Australia argued that advisers should always place their clients' interests first. The Australasian Compliance Institute (ACI) supported a fiduciary duty being imposed on individual advisers.

3.116 ANZ's submission to the PJC noted that the obligation of financial planners [those who provide holistic advice] to put the client's interests first should be legislatively enshrined in order to formally establish that financial advisers owe fiduciary duties to their clients.

3.117 Many submissions raise the possibility of introducing a fiduciary duty and indicate their general support for this option. The submitters below provided detail on how they saw the formulation of the duty.

3.118 ISN proposes that all advisers be required to act in their client's best interest, and this obligation would replace the need for advice to have a reasonable basis. The obligation would require the planner to give clients their undivided loyalty, which means the financial planner must strive to avoid any actual or perceived conflict of interest. Where a conflict is unavoidable, a fiduciary must obtain 'informed consent' of the client which they say goes beyond the type of disclosure typically provided in financial services. ISN say this duty does not lead to an obligation to predict the best or highest performing products but state that this requirement would require licensees to include a variety of product types on its approved product list and would preclude volume based payments.

3.119 Choice proposes to establish a legal fiduciary duty on advisers, either similar to options being considered in the US, or like that of the UK where advisers are required to act in the best interests of clients, rather current requirements to provide a 'reasonable basis' for advice. Choice also considers that the fiduciary duty would facilitate the removal of commissions from the industry.

3.120 The FPA acknowledge and willingly accept the fiduciary obligation and propose that a fiduciary relationship based on an obligation to put the 'Client's interest first'. Placing 'Client's interests first' is consistent with the fiduciary duty of loyalty and trust, which suggests that a planner who undertakes to act on the client's behalf must not misuse the position to their own or a third party's possible advantage. The FPA has several concerns with the application of a 'best interests' style requirement for financial planners, one being that it would result in a requirement for advisers to provide the best possible advice.

3.121 AMP supports the recommendation that financial planners act in the best interests of their clients, however AMP considers that under the general law, financial advisers already have a fiduciary obligation to their clients in many aspects of their relationship. It is argued that section 945A of the Corporations Act (requirement to have a reasonable basis for advice) contains a stricter application than a fiduciary duty as it imposes an objective standard that an adviser must meet in preparing and giving advice. AMP believes this extends beyond a fiduciary duty which would require planners to act honestly, for a proper purpose, and to obtain consent to any collateral benefits. AMP thinks it is important that the duties applying to advisers are consistent with other professions.

3.122 The Association of Financial Advisers (AFA) told the committee that the category 'financial adviser' should be legislatively defined before a fiduciary duty could be imposed by legislation.

Conclusion and recommended option

3.123 Option A does not sufficiently address the objectives of Government action, notwithstanding that there may be some benefits to consumers from simplified fee disclosure, which is consistent with other current (or planned) regulation and would offer a much relatively lower compliance burden than the other options.

3.124 Further, Option C does not sufficiently address the objectives of Government action, as industry moves to transition away from commission based payments are limited in scope (both in terms of the types of payments covered and which products they apply to). This limits the effectiveness of industry led action.

3.125 While Option D is attractive, it is not preferred because it would introduce a degree of complication and uncertainty due to the limitation of the duty to circumstances where the client and the adviser's interests are in conflict. Further, the duty would not, however, be strong enough to require the adviser (or authorised representative) to ensure that products recommended from their 'approved product list' were not only appropriate but also in the best interests of the client.

3.126 Option E is also not preferred, because notwithstanding its benefits in addressing Government objectives, the costs and potential industry impact are too prohibitive.

3.127 The preferred option is a combination of options B (legislative ban on conflicted remuneration structures) and F (best interest's formulation). The options impose a ban on conflicted remuneration structures and also introduce a fiduciary-like best interests formulation (which supports the ban on conflicted remuneration structures). The best interests formulation recognises that many conflicts exist but places additional obligations on advisers which reflect the possible detriment to consumers arising from these conflicts and imposes a general requirement for advisers to act in the best interests of their clients when giving personal advice. The best interest's formulation also encompasses the benefits of Option D.

3.128 A combination of Options B and F was found, on balance of the potential costs, benefits and risks considered for each option, to yield the greatest net benefit to the community. The analysis of impacts however, was limited because there was insufficient quantitative evidence about the costs and benefits associated with each option. The impact analysis and recommendations is largely based on a high level assessment of the potential qualitative impacts. The recommended options are however expected to have a very significant impact in this market.

Implementation and review

3.129 Treasury and ASIC will work closely with industry to devise an implementation strategy. There will be an appropriate implementation period. The ban on conflicted remuneration structures may be progressed in phases.

3.130 Further public consultation on any draft legislation implementing the recommendations is also envisaged prior to introduction of the Bill into Parliament.

3.131 ASIC will need to closely monitor and enforce the ban, in particular to monitor for developments that may see these payments be progressed through alternative mechanisms. The Government will also continue to monitor the application of the regime to ensure that it is operating effectively.

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