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Inquiry into Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

6 May 2014

Dear Committee Secretary

Commonwealth Bank's Wealth Management business unit (CBA WM) has more than 5,500 employees throughout Australia, New Zealand, United Kingdom, Singapore, Indonesia, China, Hong Kong, Japan, France and the United States. It is comprised of four operating businesses, Colonial First State Global Asset Management – the asset management business, Colonial First State – the retail distribution business, Wealth Management Advice – the financial advice business, and Comminsure – the Life and General Insurance business.

The largest impact of the Future of Financial Advice (FOFA) reforms is to Wealth Management Advice (WM Advice), however, Colonial First State, as a large provider of superannuation and investment products, is also significantly affected.

WM Advice is Australia's third largest financial advice business with around 1,800 salaried and aligned advisers. WM Advice provide financial advice to both CBA and non-CBA customers through two employed advice models in Commonwealth Financial Planning, BankWest Financial Advice, and three self-employed aligned adviser networks, Count Financial, CFP Pathways and Financial Wisdom.

CBA WM appreciates the opportunity to provide a submission to the Committee in response to its Inquiry into *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* ("the Bill").

We support the overall aims of the original FOFA reforms that, *"will improve the quality of advice, strengthen investor protection and underpin trust and confidence in the financial planning industry. These reforms should ultimately encourage more people to seek financial advice."*[1] However, we are concerned that some aspects of the FOFA reforms which operationalise those policy principles create unnecessary complexity and burden on industry, thereby reducing the availability and increasing the cost of advice to consumers.

We commend the Government for the changes it proposes to FOFA, upholding its 2013 election commitments. These refinements achieve an appropriate balance between consumers' best interests, making advice more accessible and affordable for all Australians and reducing unnecessary red tape. Further, as the Committee will appreciate there has been industry criticism about the level of uncertainty created by the FOFA reforms as presently constituted. It is therefore important that this range of, largely technical, amendments to the existing provisions are now legislated without delay.

We have contributed to the Financial Services Council (FSC) submission to this Inquiry and we endorse that submission, including the supporting legal advice. Our comments in relation to the Bill, and comments about how we are delivering on certain aspects of the FOFA framework more generally, are contained in the attachment. In this document we also emphasise areas of particular concern with the structure of the existing provisions and the need for change. This approach does not in any way diminish our support for the all of the reforms proposed by the Government.

Thank you again for the opportunity to respond to the Inquiry. We would be pleased to speak to the Committee as part of any public hearings.

If you have further questions in relation to our submission please contact me

Yours sincerely

Marianne Perkovic
Executive General Manager, Wealth Management Advice

[1] "The Future of Financial Advice: Information Pack", the Hon Chris Bowen former Minister for Human Services, Minister for Financial Services, Superannuation and Corporate Law, 26 April 2010

ATTACHMENT

1. The need for greater access to affordable financial advice

CBA WM believes in the value that quality financial advice can have on the impact of the retirement income of Australians. However, quality financial advice must be affordable to ensure all Australians are able to access it.

The FOFA reforms have the potential to increase standards in financial advice. Unfortunately, the current legislative framework as amended by FOFA does not assist consumers to access advice at a reasonable cost, and this is likely to impact the level of retirement savings consumers can enjoy.

Research by Investment Trends indicates that there remains a disparity between the cost of providing advice and a typical client's willingness to pay.

The research shows that the typical cost to industry for full service financial advice is $2,400, or $1,100 for more limited advice. The research also shows that customers expect to pay a maximum $500 for modular advice (or piece-by-piece advice), and $450 for limited advice.[2]

The Regulatory Impact Statement (RIS) accompanying the Bill indicates the Government's refinements to FOFA will deliver initial cost savings to industry of around $90m and annual cost savings of $190m.

In removing unnecessary costs associated with implementing part of the FOFA reforms, the Bill also maintains strong consumer protections expected by financial advice clients and encourages the delivery of affordable advice to the community.

2. Our response to the FOFA Reforms

CBA WM has embraced the spirit of the FOFA reforms, already having implemented significant changes within its businesses. For example, to ensure our network of advisers provides advice in the best interests of clients we have implemented specific process for advisers to adhere to in accordance with the 'safe harbour' provisions when providing advice to clients. We have also developed and delivered an extensive training program and made changes to the way we prepare advice documentation and disclosure materials.

[2] Investment Trends September 2013 Advice and Limited Advice Report

For any given client circumstance, to the extent that our advisers consider that a financial product is required to fulfil an identified advice strategy, they will review a broad range of potentially suitable products. We utilise a team of research experts to narrow the field of products down to a selection that are suitable for our client base. Within our advice licensees the range of investment products our advisers can recommend represents a diverse mix of products across the industry. Further, often these investment products are managed either by single external investment managers or a range of managers (multi-manager portfolios).[3]

The introduction of FOFA has impacted financial adviser remuneration structures across the industry. Within WM Advice we have moved our remuneration arrangements for our employed advisers away from incentives based on the value of product recommendations made to a “balanced scorecard” approach that focuses firmly on quality advice. In addition we have introduced two ‘gate openers’ that must be met before any incentive payment is received. These requirements relate to risk culture and risk management capability. We have also implemented measures to withhold remuneration if advisers have not met certain minimum risk and compliance standards

Despite all the legislative amendments to date, there remains a number of uncertainties within the legislation. This remains a concern to the business and more importantly to our individual advisers, and reinforces our support for the Bill.

3. Comments on the Bill

CBA WM supports the Government’s reforms to FOFA as foreshadowed in its election policy announcement,[4] the former Assistant Treasurer’s media release on 20 December 2013[5] and substantially translated into legislation through the introduction of the Bill. We also note that in general these legislative changes are not new and were the subject of detailed discussions with the former Government prior to the last election.

Without responding to each of the reforms in detail we express our particular support for the following reforms:

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[3] CBA WM Advice Research
[4] Contained within “The Coalition’s Policy to Boost productivity and Reduce Regulation”, July 2013
[5] “Delivering affordable and accessible financial advice”, media release by Senator the Hon, Arthur Sinodinos, form Assistant Treasurer, 20 December 2013.

- **Removing the opt-in requirement**, ensuring advisers no longer need to seek their client's agreement every two years;
- **Removing the retrospective nature of the Fee Disclosure Statement (FDS) requirement** so that advisers do not need to provide FDSs to clients who entered into an ongoing fee arrangement before 1 July 2013;
- **Removing the 'catch all' provision from the best interests duty** so that advisers can be confident that they have provided advice which is compliant with their obligations under a definitive and unambiguous safe harbour provision. It is unacceptable for advisers to have to speculate on what they need to do to confidently rely on a safe harbour defence;
- **Amendments to the best interests duty to allow for the provision of scaled advice**. This is critical to permit increased access to affordable and quality financial advice in the community;
- **The exemption of general advice from the ban on conflicted remuneration**. Again this is essential to facilitating greater access to information and basic advice; and
- **Clarifications to grandfathering arrangements** to ensure they facilitate movement of advisers between licensees, where they choose to do so, whilst maintaining access to grandfathered benefits.

We also encourage the Committee to recommend that relevant legislative amendments should be pursued as part of this package of reforms consistent with the Government's policy position on life insurance inside super. This would limit the ban on conflicted remuneration to life insurance products within super where no financial product advice has been provided, except in relation to MySuper products.

In the comments below we address two critical areas of concern: i) the application of the FDS amendments in the Bill; and ii) ensuring appropriate access to advice for default superannuation fund (employer super) members. The first issue emphasises the priority we place on achieving legislative amendments to give effect to the Government's proposal. The second issue is not specifically contemplated as part of the Government's reforms, but has been raised previously and we argue is required to ensure default super members have access to intra-fund advice from specialist financial advisers.

i) **Fee disclosure statements**

Difficulties with Fee Disclosure Statements if applied retrospectively

Under FOFA, the requirement to produce Fee Disclosure Statements (FDSs) commenced on 1 July 2013. This requires financial advisers to send all clients who pay ongoing advice fees an annual statement providing information on those fees paid in the previous twelve months. The statement must also include a summary of the ongoing services both promised and provided during the statement period. Significant costs are being incurred by financial planning businesses to implement the FDS requirements.[6]

Concerns were raised during the initial consultation phase regarding the retrospectivity of this reform - FDSs apply to a financial adviser's existing (pre-1 July 2013) client base. Industry stakeholders argued that it costs significantly more to produce a fee disclosure statement for a pre-1 July 2013 client than for a post-1 July 2013 client.

This was contrary to the original design of the FOFA reforms, which were to be prospective only. In the FOFA package released on 28 April 2011, it was widely accepted that measures such as FDS statements, would only apply prospectively. The inclusion of a retrospective requirement was not part of the consultation process, and was included late when the Bill was introduced into Parliament in October 2011.

As part of a broader concern, FDSs have been criticised for duplicating existing information disclosed to investors. For example, the information required within an FDS is already provided through an initial Statement of Advice and on an ongoing basis through regular product provider statements. Making matters worse, for large licensees a complex and expensive system build is required to collect data from multiple sources to complete the FDS obligations for existing clients.

Given these overriding concerns, CBA WM believes the FDS requirements represent a layer of consumer protection and disclosure that may cause confusion for customers as they will receive duplicate reporting on adviser fees from their product provider. To avoid that confusion, it is important that advisers have the ability to educate and

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[6] Whilst there are additional industry costs from providing any FDS, including system development, preparation, mailing and other expenses, the RIS[6] related to the Bill estimates that average annual savings of $40.8 million, and a once-off implementation cost of $0.8m could be expected by ensuring fee disclosure requirements apply only to prospective clients.

explain the nature of these statements at the outset of the ongoing advice relationship. This is not possible for existing clients.

The Government has realised the significance of these concerns. The Hon Senator Arthur Sinodinos stated in his announcement on 20 December 2013 that the Government "*will streamline the existing requirements to ensure that the requirement to provide fee disclosure statements only applies to new clients from 1 July 2013. Applying this requirement to existing clients is overly onerous as the fee disclosure arrangements are significantly more costly to apply to pre-1 July 2013 clients."*

From this announcement it was clear to industry that the Government intended to change the nature of the FDS requirements so they only applied prospectively to new clients from 1 July 2013. By limiting the FDS requirements to new clients, the amendments offer a more efficient and logical transition to FOFA, and allow advisers to explain to the customer the details of the FDS requirements at the outset of the ongoing service relationship in the context of other statements the client may receive e.g. from product providers.

Following the Government announcement, ASIC noted it *"will not take enforcement action in relation to the specific FOFA provisions that the Government is planning to repeal. For example, we will not take action for breaches of current section 962S of the Corporations Act 2001, which requires fee disclosure statements to be provided to retail clients with ongoing fee arrangements entered into before 1 July 2013.*"[7]

Taken as a whole, these announcements were a clear signal to industry that the current legislative requirements would change. As a direct result of these announcements, some licensees and advisers took the sensible approach of modifying their implementation plans, placing fewer resources on building a complete solution for existing clients and diverting attention on the application of the reform to new clients. Given the size and scope of the implementation required for FDSs, involving the construction of a whole new IT system, we had already approached ASIC directly for temporary relief from the obligations to ensure we had time to build a solution for existing clients. Work on this solution remains ongoing.

Policy intent and the draft legislation

Unfortunately, in March 2014 as the financial services industry reviewed the Bill tabled in Parliament, concerns were raised around the misalignment between the Government's stated intention on 20

[7] ASIC MR 13-355 Update on FOFA https://www.asic.gov.au/asic/asic.nsf/byheadline/13-355MR+ASIC+Update+on+FOFA?openDocument

December 2013, *"to ensure that the requirement to provide fee disclosure statements only applies to new clients from 1 July 2013"* and the actual drafting in the Bill.

This occurred as the draft of the Bill did not in fact provide retrospective relief. The relevant provisions are contained in section 1531D of the Bill, in Division 2 of the Transitional Provisions of the Bill. Instead of commencing from 1 July 2013 the Transitional Provisions commence when the Bill receives Royal Assent. The effect of this is that the obligation to produce an FDS for clients applies where the first disclosure day (the anniversary of the commencement of the original ongoing fee arrangement) falls after 1 July 2013. The closer to 30 June 2014 it is before the passage of the Bill, the less effect this provision can have.

Clearly not in accordance with the Government's intention, the drafting of this section creates uncertainty as the lack of retrospective relief and leaves financial planning businesses exposed to the potential for regulatory action.

Recommendation

We recommend a technical amendment is made to the current drafting of the Bill to clarify that the relevant provision commences on 1 July 2013 in relation to new clients (i.e. the first FDS is not required until at least 31 July 2014). This would ensure the Government's policy intent is met and financial planning businesses that acted in good faith in accordance with the Government's commitments are not unduly impacted.

We also recommend the Committee supports the swift passage of these important provisions of the Bill to ensure financial advisers can operate with certainty.

ii) Access to advice for default superannuation fund members

Financial advisers who specialise in advising employers and employees (Corporate Super Advisers) on the selection of an appropriate and suitable default fund provide a valuable source of advice to workplaces across Australia.

In addition to assisting an employer to select a default superannuation product for their employees, a Corporate Super Adviser will usually also offer their services to employee/members of the relevant employer plan, providing valuable education and other services to members on matters relating to their existing interest in the fund.

In general terms this model has succeeded in providing basic advice and guidance to super fund members where access to such advice may not otherwise exist.

Corporate Super Advisers have typically relied on ongoing fees and commissions paid by the fund for the provision of these services to members instead of receiving a fee paid directly by the employer (although this can also occur).

The combination of the ban on conflicted remuneration under FOFA and the Stronger Super legislation has removed the opportunity for corporate super advisers to receive remuneration in this manner. As a result we are concerned this will act as a barrier to superannuation trustees being able to deliver access to basic and affordable financial advice to their members.

This issue has previously been raised by the Corporate Superannuation Specialists Alliance and others before the Parliamentary Joint Committee Inquiry (PJC), with the Committee recognising the importance of these services and the need for employers to have flexibility in chose the right form of remuneration to meet their needs.
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The final report to the Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, released in February 2012, noted:

> *5.51 The committee considers that corporate superannuation specialist firms promote choice in the market and these valuable services should continue to be provided. The committee emphasises that employers may choose the form of remuneration most suitable to their circumstances following the reforms.*
>
> *5.52 The committee believes that corporate superannuation specialist firms should continue to receive benefits where they represent a 'reasonable fee for service' or a value of scale efficiencies.*
>
> *5.53 The committee proposes that Treasury conduct further consultation with the corporate superannuation*

> *specialists firms to discuss alternative viable models of remuneration that align with the FOFA reforms.*[8]

With the introduction of MySuper and the ability for superannuation trustees to deliver simple advice to members through an intra-fund advice service there was some expectation this would permit third party Corporate Super Advisers to receive intra-fund advice payments from a trustee for offering their services to the relevant employee/members.

The trustee responsible for the receipt of these payments has a responsibility to ensure that the conduct of the funds is aligned with the interests of members through their obligations in the Superannuation Industry (Supervision) Act 1993. As part of trustees obligations, this provides an opportunity for them to consider the payment of a fee, however this must be in line with APRA's outsourcing standards, SPS 231. Combined, these obligations provide a significant framework to protect the interests of members.

Indeed a primary element of the original FOFA announcements in April 2010 was the introduction of the provision of low cost simple advice (known as Intra-Fund Advice).

Through ASIC's refusal to issue a no action letter to an applicant[9] in relation to a typical situation where intra-fund advice is provided by Corporate Super Advisers, we are concerned the ban on conflicted remuneration applies to these circumstances. That is, where a Corporate Super Adviser or licensee provides personal or general advice to an employer on the selection of a default superannuation fund and also provides services (usually only factual information or general advice) to fund members/employees, the receipt of intra-fund advice fees from the recommended fund in exchange for these services is conflicted.

This is likely to remain the case even if the intra-fund advice fees are dollar-based (per member fees) and applies irrespective of any compliance controls the licensee may have in place.

We remain of the belief that this outworking has unintended consequences which need to be resolved to ensure FOFA can truly deliver on its original aim of providing access to affordable advice for more Australians.

[8] http://www.aph.gov.au/~/media/wopapub/senate/committee/corporations_ctte/completed_inquiries/2010_13/future_fin_advice/report/report_pdf.ashx

[9] ASIC Report 371, paras 19-21, Overview of decisions on relief applications (February to May 2013), September 2013.

Whilst the conflicted remuneration provisions do not appear to prohibit business models where a superannuation trustee delivers advice and education services to members itself (through representatives it employs directly), they do impact the ability to contract with third party service providers for the provision of such services. There are many superannuation funds who either do not have the internal capabilities to provide these services to members, or who would simply be more comfortable relying on an expert service provider such as a Corporate Super Adviser. This now represents a market distortion which should be removed.

Further, the current application of the ban on conflicted remuneration appears to have broader application. In the circumstance where a third party adviser or licensee provides advice to an employer on default fund selection and is then remunerated for a 'non-intra-fund advice' fee for service basis (dollar or percentage based fee) for advice provided to any employee/member of the selected fund, this is likely to be considered conflicted.

Recommendation

We believe this circumstance could be addressed by an appropriate modification of the application of section 761G of the Corporations Act 2001 to treat employers as wholesale clients for the purposes only of the conflicted remuneration provisions of Part 7.7A. In the context of advice given by Corporate Super Advisers as discussed above, the employer would no longer be the retail client and instead only the employees/ prospective members of the fund would be treated as the relevant retail clients for the purposes of conflicted remuneration.

This would also mean, in providing advice to the employer on the selection of a default fund, the best interests obligations would apply with respect to the interests of the employees/members who actually benefit from the fund selection decision and benefit from the receipt of the ongoing provision of services by the Corporate Super Adviser.

The solution mentioned above addresses these arrangements for the purposes of the conflicted remuneration provisions and better facilitates intra fund advice by persons familiar with the fund.