Dissenting Report by Labor Senators

Introduction

1.1 The Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 moves to significantly weaken the Future of Financial Advice reforms put in place by the former government. In this dissenting report, Labor Senators examine the legislative process to-date and key features of the Government's legislation including: the best interest's duty, scaled advice, conflicted remuneration, and opt-in and disclosure requirement provisions, before considering the merits of the proposed legislation as a whole.

1.2 On Thursday 22 May 2014, the Senate Economics Legislation Committee conducted a one day hearing into the Government's legislation changes.

1.3 A number of industry and consumer stakeholder groups gave evidence before this committee, providing various levels of support and opposition to the bill.

1.4 A snapshot of evidence given during the one day hearing, not necessarily representative of every stakeholder position, follows:

Mr Mark Rantall, Chief Executive Officer, Financial Planning Association of Australia:

> the FPA strongly opposes any possible reintroduction of commissions for financial product advice on superannuation or investment products. There are several risks which are associated with commissions for general advice. Firstly, we are extremely wary of general advice business models which encourage a complementary sales model of financial product issuance and distribution. The conflicted remuneration which drives these business models poses a real risk of product misselling to retail investors and was rightly banned by the future of financial advice reforms. Secondly, commissions incentivise the provision as a general advice as a form of consumer education or a replacement for personal advice. General advice is inappropriate for that purpose as it makes it more difficult for consumers to distinguish personal financial advice from marketing material or product sales. Thirdly, commission payments have also eroded public confidence in our financial system. Australians will not have the confidence in our financial system as long as providers of products or advice are exposed to perverse incentives such as commissions. Finally, allowing superannuation investment commissions to be paid on general advice has the potential to shift licensees and representatives away from the provision of personal advice in order to earn commissions. As long as the differences between general advice and personal advice are insufficiently clear to consumers, general advice will be perceived as a less costly form of personal advice. This perception of general advice influenced by the perverse incentives

created by commissions increases the risk to consumers and being sold inappropriate high-risk tier one products.[1]

Mr Ian Kirkland, CEO, consumer group CHOICE:

we are concerned about the watering down of the best-interest obligation, the changes to rules about conflicted remuneration, the removal of the requirement that clients opt in to fees and the removal of the requirement for annual fee disclosure statements for arrangements commenced prior to 1 July 2013. We see these things as pretty basic consumer protections and, indeed, signs of basic good practice in business that any financial adviser should be happy to sign up to. We have noted the costs to industry that have been spoken about. We feel that the costs to consumers also need to be considered—and these are best demonstrated by some of the significant collapses and crises that we have seen where consumers have lost millions and millions of dollars. That is what happens when financial advice goes wrong. In short, we think FOFA was an important step forward. We would be deeply concerned about any winding back of the protections that were brought in through FOFA and we would encourage the committee to recommend that these amendments be abandoned.[2]

Mr Richard Webb, Policy and Regulatory Analyst, Australian Institute of Superannuation Trustees:

Mums and dads expect advice from advisers and they expect sales from sales people. Investors have an understanding of the difference between those two terms. We note that the Cooper review wrestled with this and concluded that:

… commissions should be banned on all insurance products in super, including group risk and personal insurance. Trustees will continue to be able to offer life, TPD and income protection insurance in MySuper and choice investment options …

This was on top of the Ripoll report, which recommended banning commissions on financial products entirely at paragraph 6.56. If it is still the case that banks wish to provide conflicted remuneration to their sales staff, the answer is not to allow advice to be carved out.[3]

Ms Robbie Campo, Deputy Chief Executive, Industry Super Australia:

Industry Super Australia is concerned that the measures proposed in the bill being considered by this inquiry will significantly dilute key consumer protections in financial advice law and therefore increase the likelihood and impact of future financial advice scandals.

The general advice exemption, obviously, has attracted much criticism. The rhetoric offered in support of creating this exemption talks about the need

1 *Committee Hansard*, 22 May 2014, p. 19.

2 *Committee Hansard*, 22 May 2014, p. 11.

3 *Committee Hansard*, 22 May 2014, p. 47.

> to ensure that people can access assistance and advice, particularly from bank tellers. But, in our view, this is not really what this exemption is about. There is already a complete exemption for basic banking products in the FOFA legislation. Therefore, what we are talking about is allowing commissions and other forms of conflicted remuneration to be paid on complex products, including superannuation but also others like managed investment schemes and leveraged products, which have been the subject of many previous inquiries due to the consumer losses that have ensued.[4]

Ms Josephine Root, National Policy Manager, Council of the Ageing Australia:

> In our submission, we outline our concerns around the weakening of the best interest test, the removal of the requirement to have clients opt in every two years, the allowance of scaled or scoped advice and the move to allow commissions for more general advice products. No doubt there will be some questions on our views.
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> We believe the cumulative effect of these changes is to seriously weaken the reforms, giving less consumer protections and ultimately undermining confidence in the financial advice sector. We are concerned that people will opt out of getting financial advice and, therefore, not get the maximum benefits that they could and in the long term be a cost on the taxpayer and government because they will move to not having sufficient funds in retirement.[5]

1.5 Experienced financial journalist, writer at the Business Spectator, and ABC Finance Reporter, Mr Alan Kohler, wrote an opinion piece on 26 March entitled 'Why FoFA should have been only the start of reform' where he said:

> Acting Assistant Treasurer Mathias Cormann should do much more than tweak the amendments to the Future of Financial Advice legislation after he consults "in good faith"; he needs to rethink the Government's whole approach to the subject.
>
> Under the cover of streamlining the laws and removing red tape to lower cost, the Government is proposing eight changes to the law that will allow banks to once again use licensed financial advisers to sell investment products while pretending to provide independent advice.[6]

1.6 And:

> These amendments add up to the comprehensive return of disguising sales as independent advice, which the advisers themselves have been trying to get away from.

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4 *Committee Hansard*, 22 May 2014, p. 55.

5 *Committee Hansard*, 22 May 2014, p. 66.

6 www.businessspectator.com.au/article/2014/3/26/politics/dont-tweak-minister-rethink

> Not only does it make them feel grubby and deceptive to pretend to be advising when they are actually selling stuff on commission, they know that fewer and fewer people will get advice if they can't trust it.[7]

1.7 In February 2009, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) resolved to inquire into issues associated with the provision of financial products and services in Australia. The inquiry was initiated in response to a string of high profile collapses of financial product and service providers, such as Storm Financial and Opes Prime.[8]

1.8 The committee's final report in November 2009 (the PJC report) found that significant changes to the regulatory regime for the financial advice industry were warranted. It made a series of recommendations designed to 'enhance professionalism within the financial advice sector and enhance consumer confidence and protection'.[9]

1.9 In response to the PJC report and a comprehensive consultation process the former Labor government introduced the Corporations Amendment (Future of Financial Advice) Bill and the Corporations Amendment (Further Future of Financial Advice Measures) Bill. These bills were subject to a further inquiry by the PJC and received Royal Assent on 26 June 2012.

The process

1.10 The Government has simply not made the case for changing the Future of Financial Advice (FOFA) reforms and that is borne out through the evidence before this committee inquiry.

1.11 The process that culminated in the introduction of the legislation under review began with the former Assistant Treasurer releasing details for public consultation days before Christmas. The shambolic and chaotic 'two track' process, of pursuing regulation mirrored by legislation, has caused considerable uncertainty for businesses and widespread concern for Australian investors.

1.12 The methodology and lack of process adopted by the Government to dismantle the FOFA reforms has created uncertainty and concern resulting in a broad-based community coalition against any government changes to these reforms.

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7 www.businessspectator.com.au/article/2014/3/26/politics/dont-tweak-minister-rethink

8 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 4.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 4.

1.13 The proposed Government changes are not minor or technical in nature but rather a complete undermining of the core principles of best interests duty, consumer protection and lifting the standards to a professional level.

1.14 In summary, the Government's bungling of the process to put in place regulations and legislation is such that even moves to make sensible technical or grandfathering changes are likely to face significant community-led resistance.

1.15 Labor Senators note the announcement by the acting Assistant Treasurer of 24 March that the Government has 'paused' the implementation of planned Regulations, and in the intervening period, there have been discussions with industry stakeholders on new legislative and regulation changes to the FOFA laws, independent of this Senate inquiry process.

1.16 The acting Assistant Treasurer committed to 'consult in good faith with all relevant stakeholders on the Future of Financial Advice Regulations'. But it is clear to Labor Senators that this engagement has been limited and not dealt with the substantive concerns of many parts of the financial services sector.

Best Interests Duty

1.17 The Best Interests Duty is a key element of the original FOFA reforms aimed at improving the quality of financial advice, this duty provided that advisers must act in the best interests of the client.

1.18 Labor Senators note the evidence of Mr Paul Drum, CPA Australia, the best interests duty is the 'cornerstone of the FOFA reforms', with 'the ability to drive a cultural change within the financial services industry'.[10]

1.19 The bill seeks to remove paragraph (g) in Section 961B(2) of the 'safe harbour' provisions, known as the 'catch-all' of the Best Interests Duty as well as section 961E.

1.20 Labor Senators also note that the Safe Harbour provisions through section 961B are designed to provide security and protection for advisors by ensuring a proper process including part (g), which is further explained in the regulations to provide clarity.

1.21 Labor Senators note the concerns of some in regards to 961B(g) however agree with Professor Paul Latimer that the open-ended nature of 961B(g) ‘removes a static and inflexible advice model (box ticking) that may fail to take full account of all the client's relevant circumstances'.[11]

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10 *Committee Hansard*, 22 May 2014, p. 29.

11 *Submission 2*, p. 13.

1.22 Labor Senators note that concerns raised by the Council Of The Ageing (COTA) around the removal of 961B(g) that:

> If this last step were to be removed the other six steps become a 'tick a box' checklist and weaken the requirement for advisors to reflect in an overall sense on the advice they are giving and whether it would as a whole be considered in the client's best interest. The inclusion of paragraph (g) provides an extra degree of security for consumers that the advisor is acting for them.[12]

1.23 It is also clear that no evidence or cases of failure have been found or presented to this Inquiry in relation to part (g), which has been in operation since 1 July 2012.

1.24 Labor Senators believe that the best interest duty is driving cultural change in the industry and that removal of 961B(g) and 961E will reduce compliance with the best interest duty to little more than 'tick-a-box' approach and has the potential to result in the provision of poor advice not in the client's best interests.

Scaled Advice

1.25 A key objective of the FOFA reforms was to facilitate access for retail clients to financial product advice, including 'scaled' advice, that is, personal advice that is limited in scope.[13]

1.26 The bill seeks to aid in the provision of 'scaled' advice by the addition of subsection 961B(4A) and new paragraph 961B(2)(ba).

1.27 Labor Senators agree with the potential of 'scaled' advice to increase the quantity and reduce the cost of financial advice sought by Australians.

1.28 However Labor Senators are particularly concerned that the proposed changes in the bill will lead to advice that does not fully take into account the relevant circumstances of the client and is not in the client's best interests.

1.29 Particularly, Labor Senators note an ASIC shadow shopping survey that, ASIC, when reviewing the results, saw some evidence that the scope of advice was inappropriate. It noted that in several instances, 'particular topics were excluded from the scope of the advice, to the potential benefit or convenience of the adviser, and to the significant detriment of the client'.[14]

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12 *Submission 10*, p. 4.

13 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, p. 7.

14 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, p. 8.

1.30 Labor Senators also particularly note the concerns of Ms Robbie Campo of Industry Super Australia (ISA) who cited the Explanatory Memorandum that 'this mechanism would be able to be used by a client and adviser to agree that only the products of a particular provider would be considered in the advice'.[15]

1.31 Labor Senators note that changes that would allow an adviser to benefit from excluding topics from advice, as well as changes that allow that only products from a particular provider be considered cannot possibly be regarded as meeting the intention of the best interests duty.

Conflicted Remuneration

1.32 The banning of conflicted remuneration, with some minor exemptions, from general advice and personal advice was a significant factor in reforming the culture and public perception of financial advice.

1.33 The bill seeks to lift the ban on conflicted remuneration in prescribed circumstances for general advice and redefines what is to be considered conflicted remuneration for personal advice.

1.34 Labor Senators note that concerns raised by stakeholder groups, including financial planning industry associations, around the reintroduction of conflicted remuneration structures and the potential for this to lead to unethical practices.

1.35 Labor Senators also note the evidence of Mr Matthew Linden from Industry Super Australia who quoted research from Rice Warner on the direct cost to consumers of the changes, including the return of conflicted remuneration, in the bill:

> On an annual basis, they estimate the costs are more than half a billion dollars – almost three times the estimated business savings.[16]

1.36 Labor Senators believe it is irresponsible for any government to make changes that have the potential to cost consumers up to half a billion dollars annually.

1.37 Labor Senators note the concerns raised about the use of the term 'general advice', particularly the potential for confusion among investors on the nature of the advice received and recommend that the Government legislate to change this term to 'general information'.

1.38 Labor Senators agree that consumers may be confused by the persons who offer financial product information/factual information representing themselves as financial planners or financial advisers.

1.39 Labor Senators note suggestion of the Financial Planning Association (FPA) that the term financial planner/adviser should be defined by legislation.

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15 *Committee Hansard*, 22 May 2014, p. 55.

16 *Committee Hansard*, 22 May 2014, p. 56.

1.40 Labor Senators note that the former Labor government had introduced the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 Schedule 2 of which sought to restrict the use of the term 'financial planner' and 'financial adviser'. This bill lapsed when the parliament was prorogued.

1.41 Labor Senators recommend the Government reintroduce the measures in Schedule 2 that will restrict the use of the terms 'financial planner' and 'financial adviser'.

Opt-in and annual disclosure requirements

1.42 A key feature of FOFA was the requirement for industry participants to seek their clients confirmation to pay for on-going financial advice every two years also known as opt-in, (or as a substitute to this be required to join an industry body with an ASIC approved code of conduct), as well as the introduction of a prospective annual fee disclosure statement for all clients from the commencement of the Legislation. These features were about promoting a transparent financial planner-client relationship where the client has a solid basis for confidence in the quality of advice being provided.

1.43 The bill seeks to remove the opt-in provisions entirely and to restrict the provision of annual fee disclosure statements only to retail clients who entered into the arrangement after July 1 2013.

1.44 While noting the concerns of industry about the administrative cost of opt-in and fee disclosure Labor Senators agree with the belief of Industry Super Australia that removal of opt-in will mean 'indefinite ongoing advice fees can be charged, with no ongoing requirement to provide financial advice'.[17]

1.45 Labor Senators agree with National Seniors that opt-in 'sends a message to financial advisers to refocus on consumer engagement'. National Seniors regarded the opt-in requirement as essential given Australian consumers' 'low level of engagement with financial matters', which can result in inadequate investment decisions. In its view, the original opt-in requirement would 'move a step closer to increasing consumer understanding and engagement within financial matters'.[18]

1.46 Further, Labor Senators agree with National Seniors that removing the opt-in provision was 'unacceptable and clearly inequitable'.[19] It was concerned that without this requirement the burden would fall on the less informed party in the financial advice contract—namely the consumer—and that most would remain inactive.[20] It stated:

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17 *Committee Hansard*, 22 May 2014, p. 55.

18 *Submission 24*, p. 5.

19 *Submission 24*, p. 5.

20 *Submission 24*, p. 5.

> Removing the opt-in requirement pushes the obligation onto consumers to externally monitor the performance of their portfolio and the appropriateness of their current services and fee structure. It is clear that advisers are far better equipped than consumers are to perform this task …
>
> It is a bizarre situation that the Government is proposing to subject the provision of financial advice to less stringent renewal notice requirements than are applied to general insurance arrangements.[21]

1.47 Labor Senators are also concerned about the proposed change to fee disclosure statements that would apply for new clients only. The current legislation is for disclosure to apply in relation to all clients and to diminish this to only new clients from 1 July 2013 is a retrograde change.

1.48 Labor Senators agree with the statement of the Australian Council of Trade Unions (ACTU) that 'abolishing the requirement for advisors to provide pre-1 July 2013 clients with a consolidated annual statement of fees will entrench already low levels of price-transparency and deprive many clients of information that may lead them to make better choices about who and how they pay for advice'.[22]

1.49 Labor Senators also note the extensive removal of disclosure through paragraph 2.27 of the Explanatory Memorandum that explicitly allows for fees to be altered without consent:

> Generally speaking, alterations in the terms such as a simple alteration of an existing fee, an alteration in the duration of the arrangement, or where the fee recipient merged or was taken over by another company, but the existing arrangement did not otherwise change, would not constitute a new ongoing fee arrangement.[23]

1.50 Labor Senators believe that the requirement to provide an annual fee disclosure statement should be maintained for all clients from 1 July 2013 regardless of when their arrangement was entered into as this maintains the principle of fee disclosure equally and in a fair manner.

Conclusion

1.51 Labor members of the committee note the majority report's recommendations 1 and 2 are little more than a piecemeal attempt to fix structural legislative gaps and failures using the explanatory memorandum.

1.52 Labor members of the committee believe that the bill in its current form is beyond repair and should be opposed. Furthermore, the Government should abandon

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21 *Submission 24*, p. 5.

22 *Submission 5*, p. 6.

23 Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, p. 21.

any attempts to rush in, again, a new set of regulations that in effect gut the FOFA reforms ahead of introducing new legislative charges. The lesson for the Government over the last 6 months has been that this flawed approach will only be met by hostility in the parliament and in the community.

1.53 If the Government wishes to proceed with minor and/or technical changes that facilitate industry compliance with the original FOFA reforms, then it should enter into good faith discussions with all stakeholders, including those who represent investor and consumer interests, and all parliamentary political parties.

Recommendation 1

1.54 Labor members of the committee recommend that the bill not proceed.

Recommendation 2

1.55 Labor members of the committee recommend the Government legislate to change the term 'general advice' to 'general information'.

Recommendation 3

1.56 Labor Senators recommend the Government reintroduce the measures in Schedule 2 of the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, to restrict the use of the terms 'financial planner' and 'financial adviser'.

Senator Mark Bishop
Deputy Chair

Senator Louise Pratt
Senator for Western Australia