



**AUSTRALIAN GOVERNMENT
RESPONSE
TO THE PARLIAMENTARY JOINT
COMMITTEE ON CORPORATIONS AND
FINANCIAL SERVICES**

**INQUIRY INTO THE DISCLOSURE OF
COMMISSION ON RISK PRODUCTS**

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INTRODUCTION

The importance of disclosure

Disclosure is an essential element of the consumer protection rationale underlying the *Financial Services Reform Act 2001* (FSR Act). The Government considers it fundamental that consumers of financial services receive adequate information on which to base decisions to acquire financial services or invest in financial products.

Disclosure of commissions and other benefits is a key component of the disclosure regime established under the FSR framework, especially where consumers are being provided with personal advice recommending that they acquire a particular product or make a particular investment. The disclosure of information about commissions provides consumers with information which is relevant to, and of potential value in, reaching their decision on, for example, whether they should acquire a particular financial product.

The FSR disclosure requirements recognise that if consumers are to rely on advice from other parties, it is appropriate that they be aware of any **potential** bias or influence on the advice provided. Consequently, in relation to the provision of personal advice the FSR legislation requires commission to be disclosed only where it *might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice*. At other points in the provision of financial services and products, different disclosure requirements apply (see below).

The FSR legislation was the subject of detailed, extensive and lengthy consultation and issues surrounding the disclosure of commission were carefully considered throughout that process.

Disclosure under FSR

Disclosure under the FSR regime applies in respect of financial services supplied to *retail* clients, and operates at 3 stages:

- When a person first contacts the provider of a financial service, they should receive a Financial Services Guide (FSG), which may be a relatively generic document identifying the service provider and describing the types of services it provides. The FSG should also include information regarding remuneration arrangements that are attributable to the provision of the relevant financial services, or conflicts of interest or associations that might reasonably be expected to be capable of influencing the providing entity in providing any of the relevant financial services.
- When a financial service provider gives *personal advice* (which is defined as advice that takes into account a person's objectives, financial situation and needs) they should provide a Statement of Advice (SoA). The SoA is a more individually tailored document than the FSG. It sets out the actual advice given and information about the basis for that advice. It is also required to include information about conflicts of interest, associations or remuneration (including commissions) that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice.

- At or before the time that a person actually acquires a product, the person should receive a Product Disclosure Statement (PDS). The PDS is specific to the product being acquired, and includes information relating to the benefits and risks of the product, any costs such as fees and charges, as well as information about remuneration to the extent that it will impact on any returns to the person generated by the product.

It is important to emphasise that different purposes are served by each stage of disclosure reflecting the links in the 'chain' of delivery of financial services. The FSR disclosure requirements are specifically tailored to recognise these differences.

- In relation to the PDS, the directed disclosure approach within the legislation recognises that information material to an investment decision includes costs to the person of the product being acquired. Therefore, commissions that represent a cost (or lower the return) to the person need to be disclosed at this stage.
- However, at the SoA stage disclosure is directed at informing the person of any potential conflicts of interest or influences that may impact on the advice they receive - advice which should be tailored to their particular circumstances (ie. personal advice).
 - The presence and amount of commission payable to the adviser, to the extent that it might reasonably be expected to be or have been capable of influencing the advice provided, is a relevant factor to the person receiving the advice.
 - Hence, the legislation is intended to ensure the person is put in a position to make an assessment and appropriately weight this potential for influence and this can only be done where the information is provided to them.
 - Unlike disclosure made at the point of acquisition of the product (the PDS stage), at the point where personal advice is being provided, it is irrelevant whether the payment of commission will affect the cost of the product or the return - what is important is whether the payment may have influenced the advice.

RESPONSE TO MAJORITY REPORT RECOMMENDATIONS

Recommendation 1

The Committee recommends that the Department of the Treasury and ASIC:

- *investigate claims that there could be disclosure abuses on packaged products where commission disclosure requirements vary on the products involved; and*
- *where the potential for such abuses is confirmed, should take the appropriate action to close off this potential.*

Response

The Government notes that the Australian Securities and Investments Commission (ASIC) was provided with significant additional funding totalling \$90.8 million over four years to enhance its enforcement and compliance capacity, including a dedicated amount of \$69 million for the implementation and enforcement of the FSR legislation.

In accordance with its responsibility for regulation of consumer protection and market integrity in relation to the financial services industry, ASIC will continue to monitor and promote compliance with the commission disclosure requirements of the legislation.

The Government agrees with the views expressed by supporters of commission disclosure that consistent disclosure requirements across all financial products, whether or not they are risk or investment-based, will reduce the likelihood of abuses of disclosure where 'packaged' products are involved.

Recommendation 2

The Committee recommends that the disclosure provisions for the Financial Services Guide and the Statement of Advice - at the very least - should provide an exemption for the commission component paid in respect of back-office functions performed on behalf of the product issuer or provider.

Response

The Government does not accept this recommendation.

The Government does not support giving revenue derived from 'back-office' functions any special or different treatment beyond that already provided under the FSR Act. Accordingly, it believes that payments for such functions should be disclosed in the FSG if they are received in respect of, or are attributable to, the provision of the relevant financial services. In the case of the SoA, such payments should be disclosed if they might reasonably be expected to be or have been capable of influencing the providing entity in providing the personal financial product advice.

The Commentary on the Draft Provisions of the Financial Services Reform Bill released by the Treasury in February 2000 states, in relation to the disclosure of payments for 'back office' functions in the SoA (at page 203):

"Where financial service providers and product issuers enter into an arrangement that the service provider will perform 'back office' functions on behalf of the issuer and the payment for performing those functions is included in the commission paid in respect of the individual products, then this component of the commission does not need to be disclosed."

However, the Commentary then goes on to say:

"The basis for this is that this component of commission represents payment by a product issuer to a financial service provider for the performance of services that would otherwise be performed by the product issuer, for example underwriting. These services could not be said to influence the giving of advice where the payment for the service equals the cost of performing the service." (underlining added).

Thus it has always been the intention under the legislation that commission received for the performance of back office functions is not 'automatically' exempt from disclosure, but only where the payment of commission does not influence the giving of the advice. The Commentary provides some guidance by indicating that this criterion could, for example, be satisfied where the payment for the service equals the cost of performing it.

More generally, there is by no means a consistent definition across the financial services sector of what constitutes a 'back-office' function. It is not appropriate or practically possible to exempt a range of functions/activities that are ill defined. However, the Government notes that industry and ASIC have been discussing how to address practical issues that may arise in relation to commission disclosure in a FSG or a SoA, such as defining the range of services or functions to which it applies.

The Government notes the comments of Senator Murray (at page 67 of the Committee's Report):

"To mitigate the impact on small business, it may be appropriate to include with the commission disclosure some commentary that the commission includes a back-office, salary and service component that would not normally be included in the commission of a salaried employee of the product manufacturer or owner. In this way, small business operators in regional areas would be helped in justifying their commissions to consumers to demonstrate that the price of the risk product is not significantly different despite the nominally higher commission."

The disclosure requirements do not preclude the providing entity explaining how remuneration (including commissions) is used, or the purposes to which it is put. For example, the provision in the *Corporations Act 2001* (the Act) relating to SoAs given by an authorised representative specifically acknowledges that the SoA may also include other information (see paragraph 947C(5)(b)).

The Treasury has previously indicated to the Association of Financial Advisers that it would be possible, and indeed well may be helpful to clients, for advisers to provide a breakdown of their commission payments showing what amounts or percentages are attributable to overheads and other business expenses.

Such information would need to meet the requirement that information relating to remuneration included in a SoA must be provided in a manner that is clear, concise and effective and easy for the client to understand (see *Corporations Subregulations 7.7.04(4)* and *7.7.07(4)*). Such information must also, of course, be accurate and any statements that might refer to other advice providers (such as salaried advisers) would need to be carefully worded so that they do not unfairly portray that advice delivery mechanism, or include unsubstantiated claims about a particular product provider or adviser.

Recommendation 3

The Committee recommends that the Government amend the Corporations Act 2001 so that licensees and authorised representatives are required to disclose in the Financial Services Guide the nature of their remuneration (i.e. whether salary, commission, etc.) but are exempted from the requirement to disclose details (i.e. quantum) of commissions on risk insurance products in the Financial Services Guide and Statement of Advice. The present remuneration disclosure requirements for Product Disclosure Statements should be retained.

Response

The Government does not accept this recommendation.

The FSG and SoA provisions in the Act and regulations reflect the Government's longstanding position that remuneration disclosure is a key component of the information needed to assist consumers make informed decisions which is in turn a central policy objective of the FSR framework.

The purpose of the FSG is to ensure consumers receive information, which can assist them to make informed decisions about whether or not to acquire a financial service *before* that service is obtained. In contrast, the purpose of the SoA is to provide more specific information in relation to the provision of a particular financial service, namely personal advice, *at the time or as soon as practicable after* the advice is provided.

Disclosure in the Financial Services Guide

In line with its purpose, a key element of the FSG's required content is the disclosure of information about the remuneration (including commission) that *would be* received by the person providing a financial service. This ensures consumers have information before the event of how, and how much, remuneration would be payable to the service provider (both directly and indirectly) in the event they proceed to receiving a financial service. The provisions in the law are consistent with the objective of providing consumers with information to assist them make an informed decision, including information to facilitate a comparison of services on offer from service providers.

The substantive legal requirements in relation to remuneration disclosure in a FSG have been in place since October 2001. Amendments to Corporations Regulations made in July 2003 do not detract from, and were intended to remove any potential uncertainty about, the operation of these primary remuneration disclosure obligations. The release in June 2003 of ASIC Policy Statement 175 *Licensing: Financial product advisers – conduct and disclosure* provides guidance to industry through indicating how ASIC will administer these requirements.

The Government always intended that, in line with its purpose, information about remuneration must be included in an FSG. As contemplated in paragraph 942B(4)(c) of the Act, regulations introduced in October 2001 (such as Corporations Regulations 7.7.04 and 7.7.07) deal with the level of detail and presentation of the required remuneration information. These regulations in draft form were subject to public consultation in August and September 2001.

The phrase 'does not limit the generality' in these regulations was intended to ensure that the level of information required to be provided was reasonable and did not result in an overbearing amount of detail being contained in a FSG. The regulations were amended to remove any possibility of doubt about their effect as, notwithstanding the intent of section 942B of the Act, some industry members took the view that this phrase allowed information about remuneration to not be disclosed, beyond the fact that a generic form of remuneration would be received. This interpretation was a factor in the Government's decision to amend these regulations in July 2003. These amendments were subject to public consultation in June and July 2003.

Nevertheless, the operation of the law should not result in a need to provide an onerous amount of information concerning remuneration in the FSG. The Government notes the extensive guidance provided by ASIC through Policy Statement 175. Further, the regulations provide that where a description of remuneration needs to be given, this should only be 'to the extent relevant' (see Corporations Subregulations 7.7.04(3) and 7.7.07(3)).

Disclosure in the Statement of Advice

The Government notes that the Committee has recommended on previous occasions that disclosure of the quantum of commission on risk-based insurance products not be required in the SoA.

In making this recommendation once again, the Committee majority report has accepted the importance of disclosure for consumer protection. It also acknowledged that evidence addressing the issue of whether there is a link between commission, self-interest and consumer detriment tended to be anecdotal (see paragraph 3.18 of the Committee's Report). Nevertheless, the report of the Committee majority appears to have relied on the anecdotal evidence of those opposed to commission disclosure to formulate its position.

In particular, the Committee majority seems to have accepted the claim that commission disclosure will inevitably result wholly in a move from 'up-front' to 'level' commissions. The Government understands that it has not been the experience in relation to other types of financial products that disclosure of commissions has resulted in the demise of up-front commissions. Similarly, the Government feels that the Committee majority has too readily accepted the claims of opponents of commission disclosure regarding the effect on the income of advisers.

The Government continues to hold to the view that the consumer protection benefits of the FSR commission disclosure requirements justify their uniform application across all financial products, including insurance products, whether they be risk or investment based, or a combination of the two. It does not accept the argument that disclosure of commissions on risk-based products is too complex for consumers to understand and/or may lead them to make poor choices. It also does not accept the proposition that disclosure will result in the type and scale of change to remuneration structures and commission levels suggested by those opposed to disclosure.

The Government notes that broadly comparable commission disclosure requirements have been in place for some considerable time in relation to the pre-FSR securities dealers' licensing regime without encountering the difficulties cited by opponents of disclosure.

It also notes that insurance advisers currently have an obligation to inform clients of their commission payments, which arises in the case of insurance agents and brokers if the client requests this information, and requires that they have the means to meet such requests. The Government is not aware of any arguments that insurance agents and brokers are unable to comply with requests to disclose their commissions under existing requirements. Thus, the argument that the FSR requirements that commission be disclosed without the need for a request from the client will be too difficult and/or complex to comply with suggests that such advisers presently cannot - and perhaps do not - meet the requirements of existing law and industry codes.

Recommendation 4

The Committee recommends that the Government review and report on the extent and likely effect of consolidation and restructuring in the financial sector to determine its effect on the delivery of risk insurance services in metropolitan and regional Australia. The review should place emphasis on:

- *whether there is sufficient competition in the industry to promote outcomes that are beneficial for consumers in terms of:*
 - *the quality of risk insurance advice (taking into account issues of adviser independence and expertise);*
 - *availability of face-to-face risk insurance advice;*
 - *product diversity;*
 - *services including claims handling; and*
 - *price;*
- *the role and viability of small risk insurance businesses; and*
- *whether increasing numbers of 'tied' advisers or the increasing use of direct selling are adversely affecting the quality and independence of advice available to consumers.*

The report should formulate a remedial program to correct any identified areas of market failure.

Response

The Government does not accept this recommendation.

The Government acknowledges the importance of the issues mentioned in the recommendation. It does not, however, accept that they are directly relevant to the introduction of the FSR Act and sees no present need for a review such as that suggested. Having said that, the Government will closely monitor the impact of the new regulatory framework across the whole of the financial services sector (not only risk insurance businesses) to ensure that its objectives are achieved, including that its consumer protection benefits are fully realised.