THE FUTURE OF FINANCIAL ADVICE (FOFA) REFORMS

The *Future of Financial Advice* (**FOFA**) reforms focus on the framework for the proper provision of financial advice. Their underlying objective 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.

THE FOFA REFORM PROCESS TO DATE

In November 2009 the Parliamentary Joint Committee on Corporations and Financial Services (PJC) delivered its report entitled "*Inquiry into financial products and services in Australia*".

The PJC's report, commonly known as the Ripoll Report, reported on its inquiry into retail investment in financial products (excluding superannuation) made on the basis of personal financial advice.

The PJC report which made a number of recommendations to Government made particular reference in the Review to:

- The role of financial advisers;
- The role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest;
- The role played by marketing and advertising campaigns;
- The role of the banking and finance in providing finance for investors in Storm Financial, Opes Prime and other similar businesses;
- The financial services licensing regime;
- Consumer financial literacy; and
- The adequacy of professional indemnity insurance arrangements for sellers of financial products and services and the impact on consumers.

The Government responded to the PJC Report with its *Future of Financial Advice* (FOFA) package in April 2010 and made a number of additional proposals and then embarked on industry consultation.

In August 2011 the Government released a first tranche of draft legislation and explanatory memorandum resulting in the eventual tabling into Parliament of two tranches of FOFA reforms.

The first tranche of the FOFA reforms is set out in *Corporations Amendment (Future of Financial Advice) Bill 2011*. The second tranche is in *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*.

Both Bills were passed by the House of Representatives with some late amendments negotiated by the Minister for Financial Services and Superannuation on 22 March 2012 and are due to be debated in the Senate when Federal Parliament resumes for the Winter Sittings.

NEED TO KNOW

The FOFA reforms include:

- A new statutory best interests obligation in new Part 7.7A of the *Corporations Act 2001* requiring providers of personal advice to a retail client to:
  - comply with the best interests duty;
  - only provide appropriate advice;
  - warn the client where the advice is incomplete or inaccurate; and
  - give priority to the client's interests when giving the advice.
- A ban on conflicted remuneration (including product commissions) where licensees or their representatives provide financial product advice to retail consumers.

- Other banned remuneration including:
  - a ban on volume-based shelf-space fees from asset-managers; and
  - a ban on assert-based fees on borrowed amounts.
- Restrictions around an adviser's ability to charge ongoing fees to retail clients without their agreement.
- Enhanced intervention and banning powers for the Australian Securities and Investments Commission (ASIC).

IMPLEMENTATION AND TRANSITION

During the lead up to the passage of the FOFA Bills there was much discussion around the proposed 1 July 2012 start date and the major difficulty many industry participants would have with that.

In response to calls for a 12 month delay the Government has announced that it will defer the mandatory start date from 1 July 2012 to 1 July 2013.

However, from 1 July 2012, a person can voluntarily elect to comply with the FOFA reforms by lodging a notice with ASIC.

PROVISION OF ADVICE

The Best Interests Duty

Central to the new law is the requirement that a provider of personal advice to a retail client "must act in the best interests of the client when giving the advice".

Under new section 961B(2) a minimum framework with which providers must comply when giving advice applies. To demonstrate compliance, the provider must be able to prove that it has done each of the following:

- Identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
- Identified the subject matter of the advice that has been sought by the client (whether explicitly or implicitly) and the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter ("the client's reasonable circumstances");
- Where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;
- Assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;
- If, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product, conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and assessed the information gathered in the investigation;
- Based all judgements in advising the client on the client's relevant circumstances; and
- Taken any other step that, at the time the advice was provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

Some exemptions from the framework exist where the subject matter of the advice requested by the client is a basic banking product and the adviser is an agent or employee of an Australian ADI. In their case the adviser is only required as a minimum to discharge the scoping and identification of the advice and the relevant information obligation described above.

An explanatory note to the best interests obligation clarifies how the obligation is expected to facilitate the provision of limited or scaled advice. The note observes that a client may seek limited or scaled advice and that the inquiries to be made by the financial adviser into the client's relevant circumstances will be tailored to the advice sought.

Advice must be appropriate

The provider must only provide the resulting advice if it would be reasonable to conclude that the advice is appropriate to the client.

Warning

If it is reasonably apparent that the information relating to the objectives, financial situation and needs of the client on which the advice is based is incomplete or inaccurate, the provider must warn the client at the same time as the advice is provided that this is the case and consider the appropriateness of the advice.

Priority of client's interest

If the provider knows, or reasonably ought to know, that there is a conflict between the interests of the client and the interests of the provider (or another closely related entity including the provider's associate or a financial services licensee of whom the provider is an authorised representative or an associate of a financial services licensee of whom the provider is an authorised representative) the provider must give priority to the client's interests when giving the advice.

CONFLICTED REMUNERATION

Ban

New Division 4 of new Part 7.7A of the *Corporations Act 2001* creates a ban on conflicted remuneration. The ban applies to a financial services licensee's authorised representative or other representative.

Conflicted remuneration is broadly defined in section 963A as any monetary or non-monetary benefit given to a licensee or representative who provides financial product advice to retail clients that could, because of the nature of the benefit or the circumstances in which it is given:

- be reasonably expected to influence the choice of financial product recommended; or
- reasonably be expected to otherwise influence the financial product advice given by the licensee or representative.

Without limiting this broad definition, some specific examples of conflicted remuneration are provided, including volume-related benefits dependant on:

- the total value of financial products recommended; or
- the number of financial products of a particular class recommended.

Exceptions from the ban

There are some exceptions to the ban which industry fought hard to obtain during the consultation phase with Government. They are:

Monetary commissions

- An exception in relation to general insurance products and some life-risk insurance products (but not group life superannuation policies);
- An exception for monetary commissions or incentive payments in relation to execution-only sales or issues of financial products (that is where the advice is sold with no advice to retail clients);
- An exception for "fee for service" arrangements (even where the client pays a volume-based fee); and
- Other exceptions to be included in regulations which will include certain stockbroking activities yet to be determined but likely to include the receipt of "stamping fees" from companies for raising capital on those companies' behalf where the broker is advising on capital raising products that are or will be listed.

Non-monetary (soft-dollar) benefits

Non-monetary or "soft-dollar" benefits are included in the definition of conflicted remuneration. To the extent that a soft-dollar benefit could be reasonably expected to influence financial product advice, it will be conflicted remuneration.

However, there are a number of exceptions including:

- Benefits given in relation to a general insurance product;
- Benefits under an amount proposed by Regulation (proposed to be $300) so long as those benefits are not identical or similar and provided on a frequent or regular basis;
- Benefits with a genuine education or training purpose that are relevant to the provision of financial advice to retail clients and are conducted in Australia or New Zealand, where 75% of the time (during a standard 8 hour day) is spent on professional development and any travel costs, accommodation and entertainment outside the professional development activity must be paid for by participants or its employer or licensee.

Benefits given to employees by an employer

Under section 963C, monetary or non-monetary benefits given by an employer to an employee are not conflicted remuneration where the benefit is remuneration for work carried out, or to be carried out, by the licensee or representative as an employee and:

- the remuneration is not a volume-based payment; or
- the employer is an Australian ADI, access to the benefit is dependant on recommendation of a basic banking product, and no advice relating to a product other than a basic banking product is given.

Grandfathering

The ban on conflicted remuneration will not apply to a benefit given to a licensee or representative if:

- the benefit is given under an arrangement entered into before the day on which the ban commences; and
- the regulations prescribe circumstances in which the ban does not apply.

Ban on volume based shelf fees

A platform operator must not accept a volume-based shelf space to the extent that such incentives are merely a means of product issuers or funds managers "purchasing" shelf space or preferential positions on administration platforms.

Ban on asset-based fees or borrowed amounts

Asset-based fees on borrowed amounts will be banned where the fee is for providing financial product advice that is dependent upon the amount of funds to be used to acquire financial products. A borrowed amount can include the raising of funds through a credit or margin lending facility.

CONTRAVENTIONS

Contravention of the best interests duty or the remuneration obligation attracts a civil penalty, exposure to a court order to compensate the client for loss or damage and, if the court thinks it is necessary to do justice between the parties, orders to void the contract and make such other orders as the court thinks fit.

CHARGING ONGOING FEES TO CLIENTS

The most contentious element of FOFA are the new rules under which an adviser can charge an ongoing fee to a retail client.

Under the proposal an ongoing fee arrangement will be one where:

- the fee is for personal advice by a licensee or representative of a licensee to a retail client; and
- under the terms of the arrangement entered into, a fee (however described or structured) is to be paid during a period of 12 months or more.

The definition does not however catch insurance premiums or fixed fee arrangements entered into in respect of advice given before the arrangement was entered into.

Ongoing advice fee to a retail client for longer than 12 months

Under the current law there is no requirement for advisers/fee recipients to provide ongoing disclosure of advice fees to retail clients.

From 1 July 2013, or a licensee's earlier opt-in, 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 both the previous and forthcoming 12 months. The fee disclosure statement must be given within 30 days of the end of 12 months after the arrangement was entered into.

Failure to provide the fee disclosure statement on time means the client is not required to pay the ongoing fee.

Ongoing advice fee to a retail client for longer than 24 months

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.

In order to charge an ongoing advice fee to a retail client for a period longer than 2 years (24 months), the adviser will be required to provide both a renewal notice and a fee disclosure statement to the client which will detail advice fee and service information for both the previous and forthcoming 12 months.

If the client opts not to renew the arrangement with the adviser, or does not respond to the renewal notice, the arrangement ceases and the ongoing advice fee can no longer be charged to the retail client.

Under late changes to the Bills this controversial "opt-in" requirement was watered down by the Government on the eve of the debate in the House of Representatives.

Under the changes ASIC will be allowed to exempt a financial adviser from the opt-in requirement where the person (or a class of persons) is bound by a code of conduct approved by ASIC for the purpose. Under this process ASIC will be required to satisfy itself that the relevant code of conduct obviates the need for persons bound by the code to be bound by the opt-in requirement.

Ongoing fee arrangements

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.

For ongoing fee arrangements, the client can "opt-out" or terminate the arrangement at any time.

Unless the client actively renews the agreement within the renewal period, the client is assumed to have opted out and the arrangement terminates at the end of an additional 30 days after the renewal period.

INTRA FUND ADVICE

In recognition of the importance of retirements savings not being eroded through excessive fees the Government proposes through draft legislation out for industry consultation now to allow a fund to provide intra-fund advice and to meet the cost of provision of that advice from the assets of the fund.[1]

The trustee's ability to share the cost of intra fund advice will however be subject to a number of important restrictions:

1 See Exposure Draft Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 released for industry consultation by the Minister for Financial Services and Superannuation

- The provision of advice on any of the following matters will be excluded:
  - recommendations in relation to financial products that the member holds outside of superannuation;
  - whether the member should consolidate their existing superannuation accounts;
  - the giving of a direction to the trustee by a member to invest in a specified financial product or products;
- The advice must be of a one-off or transactional nature; and
- The trustee has in place internal policies to manage the costs of those services and ensure they are not excessively used by any particular member to the detriment of other members.

IMPACT

Adviser groups are critically examining their advice models now ahead of the debate in the Senate. It is clear that new compliance frameworks will have to be developed. Moreover, there is acceptance that the reforms and in particular the best interests obligation will make a dealer group model without vertical integration difficult. At the same time superannuation trustees are rethinking their advice models and how to best take advantage of the intra-fund opportunities. Futher debate is required on how to provide limited or scaled advice and meet the new best interests duty. The landscape for the provision of advice in Australia will dramatically change as a result.

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