



The future of financial advice — beyond Ripoll

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On 26 April 2010, the federal government announced its response to the Ripoll Inquiry into Financial Products and Services in Australia. The response was in the form of an Information Pack on the Future of Financial Advice and proposed far-reaching reforms, most of which are designed to apply from 1 July 2012.

Financial advisers and the advice they provide play an important role in the financial services industry. In the wake of the collapse of Storm Financial and Opes Prime in 2008–9, the reforms aim to enhance retail investor protection and improve the quality of financial advice in the financial services industry. This article provides a summary of the government's proposed reforms.

The reforms

Contained among the numerous proposals were the following three key reforms:

- a prospective ban on conflicted remuneration structures, including commissions and any form of volume-based payment;
- the introduction of a statutory fiduciary duty for financial advisers requiring them to act in the best interests of their clients; and
- the introduction of an adviser charging regime which contains flexible options for consumers when paying for advice.

Other reforms include:

- extending “intra-fund advice” for superannuation trustees to include new topics to facilitate simple, single personal advice in a compliant manner;
- reviewing the appropriateness of the method of classifying retail and wholesale clients under Ch 7 of the Corporations Act 2001 (Cth);
- improving Financial Services Guides (FSGs) so they are more effective at disclosing material restrictions on advice, any potential conflicts of interest, and remuneration structures;
- removing the Australian Financial Services licence (AFSL) exemption for accountants providing advice on self managed superannuation funds;

- establishing an expert advisory panel to review professional standards in the financial advice industry;
- enhancing the powers of the Australian Securities and Investments Commission (ASIC) in relation to the licensing and banning of individuals; and
- appointing an expert to report on the need, benefits and cost of a statutory compensation scheme.

The proposed reforms are extensive and the devil will be in the detail. If introduced in their entirety, the reforms will no doubt require significant systems changes in the financial services industry and equally significant legislative change.

Stakeholders will be consulted on the proposed reforms, with particular emphasis on adviser charging rules and the statutory fiduciary duty, as well as the proposed legislation. The consultation for these reforms has commenced with the introduction of a dedicated website at <http://futureofadvice.treasury.gov.au>. According to the information on the website:

- Treasury will hold information sessions on the reform package in Adelaide, Brisbane, Melbourne, Perth and Sydney, to be followed by further targeted consultation on key details;
- Treasury anticipates that there will be a public exposure of draft legislation supporting these reforms in mid-2011; and
- the consultation will be closely coordinated with the Super System Review and Australia's Future Tax System review.

Key reforms

Removal of conflicted remuneration structures

The government's recommendation on a ban of conflicted remuneration structures follows the Ripoll Inquiry's recommendation to consult and support industry to develop an appropriate mechanism to cease payments from product manufacturers to financial advisers.

The ban is aimed at reducing conflicts in adviser remuneration — or, in other words, making advice

“product neutral” — in relation to retail financial products. The prospective ban will apply from 1 July 2012 to:

- all commission payments from any financial services business, relating to the distribution and provision of advice for retail financial products; and
- any form of payment with regard to volume or sales targets from any financial services business, relating to the distribution and provision of advice for retail financial products.

The ban does not initially apply to any form of payment relating to risk insurance products. The government has noted that insurance has different features from those which characterise investment products, and the issue to be explored in relation to insurance products is affordability and the potential for under-insurance. Further discussions with the industry, including on the issue of profit share, will be conducted before a decision is made on whether to extend the ban to risk insurance.

Similarly, the ban will not yet apply to soft dollar benefits due to the varied and complex nature of these benefits. The proposed expert advisory panel will consider whether these payments are consistent with the relevant professional standards.

A fee for service charged as an asset-based fee will be permitted only for ungeared products or investment amounts. Moreover, such fees must be agreed to by the client on a yearly basis, which will require funds to set up processes to deal with payment arrangements spanning several years. Other types of fee-for-service for advice (such as an hourly rate) will also be permitted.

Legislation will have the ability to carve out specified payments if unintended payments are captured or unintended consequences occur.

Statutory fiduciary duty for advisers

An equally significant reform is the government’s decision to impose a statutory fiduciary duty on advisers, requiring them to act in the best interests of their clients. More specifically, in no circumstances will it be permissible for an adviser to place their own interests ahead of their client’s interests. Irrespective of the debate over whether such a duty already exists as a matter of general law, the introduction of a statutory duty will make it clear that such a duty does apply.

To discharge this duty, an adviser must take “reasonable steps”. This means that an adviser need not base their recommendations on an assessment of every single product available in the market — which would be impractical and costly — but otherwise leaves unclear how broad an adviser’s duty is.

A significant question mark hangs over the nature of approved product lists and the operation of tied advisers in situations where the best interests of a client may lie outside a limited range of products. Indeed, the fiduciary duty may require advisers to explore other products or recommend the client see another adviser. Consequently, financial advice based on product sales may fall foul of the duty.

Another interesting feature is the formulation of the statutory duty in prescriptive terms (ie, the obligation for advisers *to act* in a particular way). This is to be contrasted with the general law notion of a fiduciary duty, which is typically cast in proscriptive terms (or a negative legal duty), which requires the fiduciary *not act* in a particular way (eg, not to profit from their position and not to be in a position of conflict).

It is important that these issues and others which may arise are considered as part of the industry consultation which has been flagged by the government. The formulation of “best interests” and the “reasonable steps” that must be taken are proposed to be developed in consultation with industry during implementation.

The adviser charging regime

If financial advice is provided to retail clients, advisers will be required to agree their fees directly with clients and disclose the structure to clients in a clear manner — including, as far as practicable, total adviser charges payable, expressed in dollar terms.

An adviser will only be able to charge ongoing advice fees if a payment plan has been agreed with the client and the client renews the service annually.

The adviser charging regime does not prevent client agreed deductions being allowed from a client’s investment to pay for financial advice, nor does it prevent flexibility in payment options. Although deductions will be facilitated by product providers, the remuneration is not set by the product provider. Consequently, it is not a commission and will not tempt advisers to prefer product providers out of self-interest.

Other reforms

No AFSL exemption for accountants

Accountants will no longer be able to give advice on self managed superannuation funds without an AFSL. However, the government proposes to investigate alternative licensing arrangements in consultation with industry, including a streamlined licensing regime.

Intra-fund superannuation advice

Simple advice (or intra-fund advice) within a superannuation context will be extended to cover new topics. A superannuation fund trustee will be able to provide



simple, single issue, personal advice on compliant matters, including transition to retirement, intra-pension advice, nomination of beneficiaries, superannuation and Centrelink payments, and retirement planning generally.

A review will also be conducted on whether simple advice is necessary outside intra-fund advice.

Simplifying disclosure

FSGs will be improved so they are more effective. It is proposed that information in an FSG should focus on the information that the investor needs to know in order to make an informed decision and be presented in clear and unambiguous language.

The Ripoll Inquiry's recommendation to make disclosures in marketing material was rejected by the government on the basis that it is more appropriate to enhance disclosures by including the information in an FSG.

Enhancing ASIC's powers

ASIC will be able to take into account a broader range of matters when determining:

- whether to issue, suspend or cancel an AFSL; and
- whether or not to ban an individual from providing financial advice.

Sophisticated investors

The criterion distinguishing a sophisticated investor from an unsophisticated investor will be reviewed in

consultation with stakeholders. The government has noted that the test of a sophisticated investor has not been reviewed in almost a decade.

Review of professional standards

The government will establish an expert advisory panel to review professional standards, including conduct and competency standards, which may include a code of ethics for financial advisers. The advisory panel may include members from industry, professional associations and academia, as well as consumer representatives and ASIC officers.

The Ripoll Inquiry's recommendation to establish a professional standards board was rejected by the government. The government commented that the establishment of such a board is a matter for the government and not ASIC, and that it was concerned about costs in operating a board and the significant overlap with the role of ASIC in enforcing competency and conduct standards.

Expert review — statutory compensation scheme

Mr Richard St John will report on the need for, and the costs and benefits of, a statutory compensation scheme.



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