

FUTURE OF FINANCIAL ADVICE REFORMS - TRANCHE 1

It's been two years in the making, but the draft legislation for the Future of Financial Advice (FOFA) reforms is finally here. Many of the proposals are commendable, but there are some which fly in the face of the Government's stated objectives. In this SuperFocus, we review the first tranche of the legislation (issued on 29 August) and what it means for you and your employees.

What is FOFA?

FOFA is the Government's response to some very bad seeds in the financial services industry. Individuals who brazenly focused on boosting their own financial future instead of their clients'. The fallout saw thousands of investors lose billions of dollars and formal inquiries conducted by ASIC.

FOFA aims to prevent events such as this from recurring, by legislating a framework for enhanced standards and practices within the financial advisory industry. To date, this is what the draft legislation looks like:

FOFA kicks in on 1 July 2012, with the aim of achieving three main objectives:

- to improve the quality and accessibility of advice for more consumers;
- to provide increased protection for investors; and
- to restore confidence in the financial advisory system.

The overarching objective is to improve the quality

and accessibility of advice. However, all three objectives are closely connected, due to the burning issue of retirement adequacy. Research has proven that quality financial advice is a positive influence on retirement savings. Hence, it's important for FOFA to achieve the last two objectives to help achieve the first.

So, let's take a closer look at what's involved with each of the first tranche proposals and how they'll impact the corporate super world.

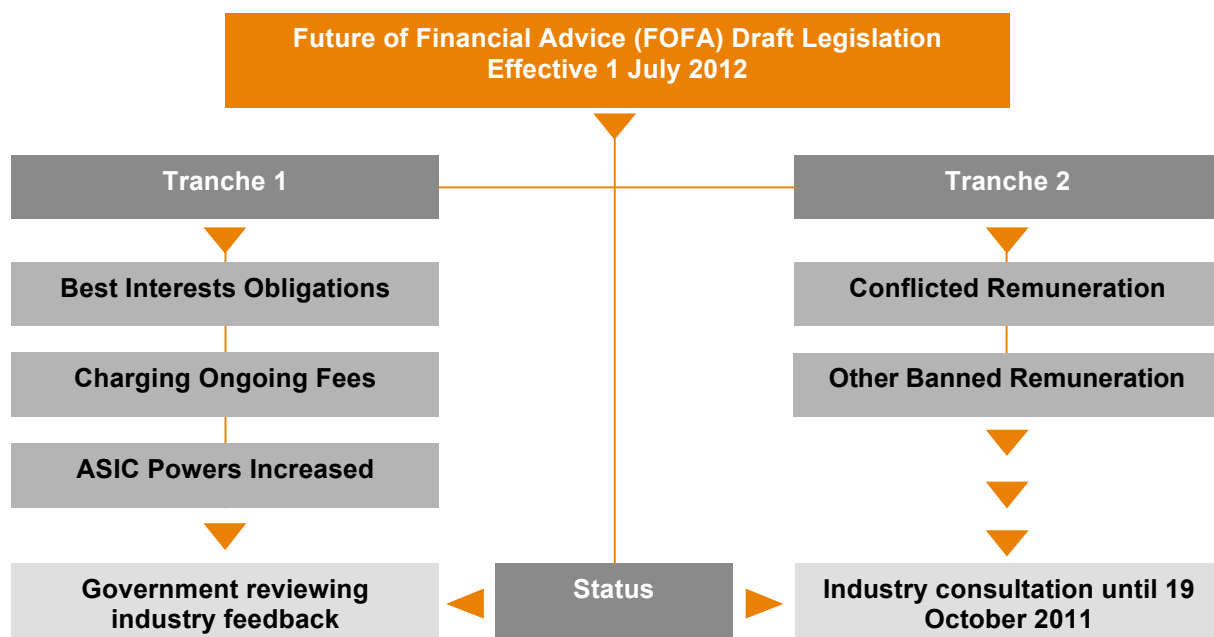
Best Interests Obligations (BIO)

This proposal is totally focused on protecting you – at a fund, employer and employee level. It emphasises disclosure and compensation for breaches at an individual and corporate level.

Client focus

The BIO operates similar to Trustee obligations, as the best interests of you and your employees must be the adviser's only priority.

In effect, your servicing adviser must have confirmed



your personal objectives, situation and needs to ensure the advice is appropriate, before advising you on a product and/or course of action.

Conflicts of interest

Where a potential conflict of interest arises between your interests and those of the adviser, your interests must be prioritised. For example, let's assume your servicing adviser has a choice of two super fund products. Both products perfectly address your objectives, needs and circumstances, but one is slightly more expensive and pays a commission. Within the confines of the current law, the adviser can legally recommend the commission-paying product. Under the BIO, this is a potential breach of legislation, as the adviser knows he will be remunerated and you'll be paying more.

Incomplete or inaccurate information

If the advice you're given is incomplete or inaccurate, the adviser must let you know. This way, you have full knowledge of your situation and can make an informed decision as to your course of action.

Penalties for breaches

Significantly, any breach of any of the BIO by an individual adviser will be to the detriment of both the individual adviser and the licensee or authorised representative. The former, in the extreme, could be banned from the industry, while breaches by the licensee or authorised representative will incur financial penalties.

What does this mean for you?

This proposal is a win for everybody. Traditionally, financial advisers have operated under a fiduciary and ethical code to "know their client, know their product and provide appropriate advice". This assumed code will now be law. Consequently, the ethical rights of you and your employees will be legislatively protected, in addition to your investment.

For the advisory industry, it will help to separate the wheat from the chaff, hopefully restoring much

needed confidence back into the industry. AXIS clients will already appreciate that we adopt a best interest approach. At an employer level, we agree on Key Performance Indicators for servicing, while at an employee level (at a minimum), we conduct risk profiles on every employee prior to providing personal advice. So, under this proposal, you'll see no change in our servicing levels or processes.

Administratively, this proposal evokes no adjustment to business processes, which is an added bonus for everyone.

The one concern AXIS has with this proposal is how FOFA intends to apply it. The draft legislation offers no detail in this respect. Hence, if you consider the above example we've provided, how will this potential breach of legislation be recognised, monitored and acted upon by ASIC? We believe clarity is required to ensure all parties are best served.

Charging ongoing fees

This proposal only applies to prospective business from 1 July 2012. Therefore, if you're in an existing arrangement with your adviser before this date, it won't apply. This proposal aims to ensure clients know the fees they're paying and the services they're receiving for those fees. And, it's arisen because of the remuneration structure generally in place for advisory services.

Many advisory fees tend to be ongoing in nature, as opposed to one-off, due to the fact that the benefits of advisory services don't tend to be realised until further down the track. This can result in clients paying for services they don't want, need or use. Some clients may also be unaware of the exact amount of fees they're paying.

This proposal aims to address this potential issue in three ways:

Fee disclosure statement

Where ongoing fees are to be charged to a client for more than a year, the adviser must provide the client with a fee disclosure statement. This statement will detail the services to be provided and the associated

fees for both the previous (once applicable) and forthcoming 12 months. In effect, the client will know the total amount upfront that they'll be charged over a 2 year period and the services they've received and will receive for that fee.

The statement must be issued at least 30 days prior to the one year anniversary of the date the client entered into the arrangement. If an adviser fails to issue the statement within this time period, the client will not be liable to pay the ongoing fee. Should a client have paid the ongoing fee despite the adviser's failure to meet the deadline for issue, the fee must be refunded to the client.

Renewal notice

In order to charge an ongoing fee for more than two years, the adviser must provide a fee disclosure statement and a renewal notice. The latter must be issued at least 30 days prior to the 2 year anniversary of the date the client entered into the arrangement. Since the client must sign the renewal notice, thereby consciously "opting in" to continue receiving the services, they will be fully aware of the arrangements in place.

If the client chooses not to sign the renewal notice or doesn't renew for some other reason (eg disengagement, inadvertent oversight), the arrangement will terminate 30 days after the renewal period.

As with the fee disclosure statement, if an adviser breaches the issue timeframe, the client won't be subject to the payment of fees.

Opt out process

Where ongoing fee arrangements are in place, a client can opt out at any time. This may be via the renewal notice, not completing the renewal notice or by other written means (eg email, SMS, fax or an online facility, such as the adviser's website).

If an adviser continues to charge a fee after a client has opted out, they could be subject to penalties of up to \$50,000 (for individuals) and \$250,000 (for corporations).

What does this mean for you?

There's good and bad news with this proposal.

Potentially better engagement and fund comparison

The good news is that it could keep members more engaged with their super. Since members will be regularly reminded of the services they're receiving and the money they're paying, super could be pushed further forward in their minds. Consequently, increased engagement could result in higher retirement savings.

It will also allow members to better compare the services they're receiving with their corporate super and other funds they have opened.

Opt in loophole

Our biggest concern is the opt in process, from an employee standpoint. If an employee inadvertently fails to renew the arrangement, the servicing of their super and any insurance will be terminated.

Higher costs

Our second concern has to do with higher costs – for everyone. Super funds will be subject to more administrative workload and expense, as every member will need to be issued a fee disclosure statement every year and a renewal notice every two years.

Financial advisory firms will also be hit with the logistical costs of preparing these notices for every client, which are, unfortunately, likely to be passed on to clients. Just how high these extra costs will be has been a matter of heated debate. While Government has somehow arrived at a cost of only \$11 per client, most of industry estimates between \$100 to \$250 per client. Since financial advice is closely tied to cost, this could nullify FOFA's objective of improving accessibility to financial advice.

Proposal is redundant

Finally, this proposal seems to make little practical sense. If an adviser is subject to the Best Interests Obligations, the provision of the fee disclosure statement and renewal notice, all while the provision of opt out is available, this proposal seems unnecessary.

All in all, the bad seems to outweigh the good with this proposal. Theoretically, while it's intended to protect investors, it doesn't appear to generally achieve this objective from a practical standpoint.

Increased ASIC powers

There's a lot of detail to this particular proposal, which we won't go into. In a nutshell, it gives ASIC greater powers to license individuals, ban individuals and licensees from the industry and impose financial penalties.

What does this mean for you?

Similar to the Best Interests Obligations, this proposal is generally good for everyone. It provides greater protection for you and your employees and offers preventative measures for untoward acts of conduct.

However, the draft legislation lacks clarity as to how ASIC will be allowed to apply these enhanced powers, which has caused concern within the industry.

Where is FOFA at now?

Industry submissions on the first tranche of FOFA, including concerns and queries, are currently being

reviewed by the Government. However, the jury is still out. The Government remains undecided as to how to resolve industry's concerns about the practical application of some of the legislation, as we've highlighted, plus those components which don't appear to meet the Government's stated objectives.

Transition period to FOFA

For all intents, FOFA is due to come into play from 1 July 2012. With the second tranche submissions closing on 19 October 2011, this leaves little time to pass the Bill before Parliament adjourns for the Christmas period.

Assuming the Bill passes upon Parliamentary resumption in Autumn 2012, this leaves only a handful of months to ensure business practices, processes and systems are up to speed to adopt the legislation. Watch this space!

And, stay tuned for our November SuperFocus, when we dissect the second tranche of the draft legislation, which was issued on 28 September 2011.

References:

Australian Government, The Treasury, Future of Financial Advice, Explanatory Memorandum (Draft), August 2011.

Corporate Super Specialist Alliance, Response to FOFA Draft Legislation Tranche 1, September 2011.

Financial Planning Association of Australia, FPA Submission on Exposure Draft 1, September 2011.

InvestorDaily, Shorten undecided on draft guidelines, October 2011.

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Feel free to contact your adviser with any questions about this edition of Super Focus

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