

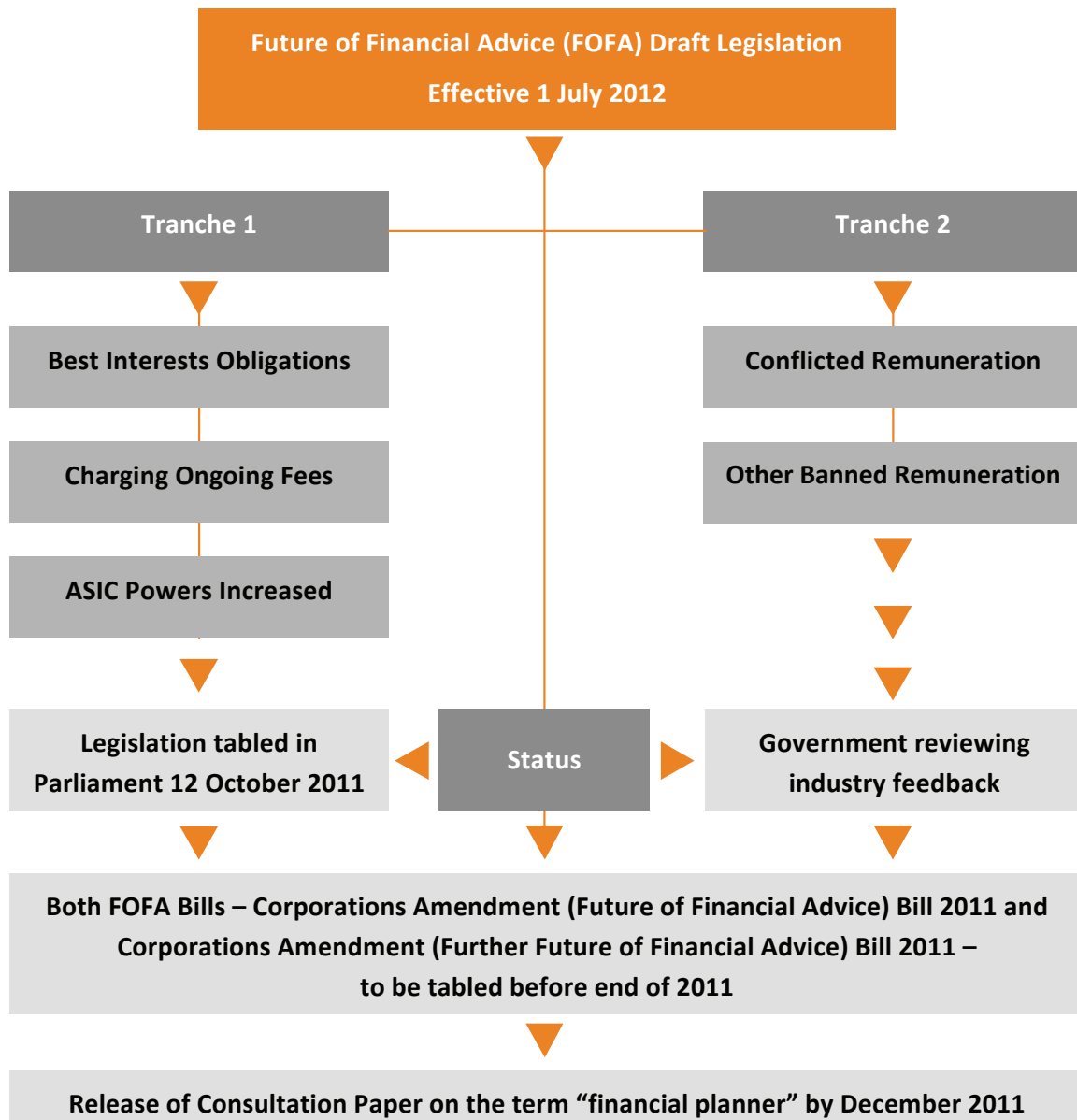
FUTURE OF FINANCIAL ADVICE REFORMS - TRANCHE 2

In last month's SuperFocus, we dissected the first tranche of the Future of Financial Advice (FOFA) reforms. Along with the Stronger Super reforms, FOFA is arguably the biggest legislative catalyst to hit the financial services industry in the last decade. In this SuperFocus, we spotlight the second and final tranche of FOFA (released on 28 September), to reveal its likely impact on the world of corporate super.

Current status of the FOFA legislation

Since our last SuperFocus, the legislation for the first tranche was tabled in Parliament and the date for industry submissions on the second tranche closed. As you can see by the following diagram, the Government has committed to tabling both Bills in Parliament before year end. Since Parliament doesn't sit in December, it appears that they're

hoping to pass the draft legislation during November 2011. Finally, ASIC is due to release a Consultation Paper (CP) to industry before the end of December 2011. The aim of the CP will be to provide clarification about the term "financial planner" and the activities that fall within the boundaries of this definition.



What's included in the second tranche?

The second tranche extends the Best Interests Obligations and is conspicuously less detailed (read as “sketchy”) and lengthy than the first tranche. These final proposals focus on the banning of conflicted remuneration and other forms of commission payments. So, let's review what's involved with each proposal and how they potentially impact you.

I. Ban on conflicted remuneration

This proposal is tied in with the Best Interests Obligations, further extending the obligations to product providers. It focuses on the traditional means by which financial advisers are typically remunerated – namely the payment of commission on products (eg super and insurance) sold to clients. These commissions can take different forms, such as an upfront percentage of funds under management or might be ongoing in nature (ie trail commission).

The issue here, as revealed by ASIC research and that of the Parliamentary Joint Committee, is that the payment of commission upon the sale of a product can influence the integrity of advice given and lead to inappropriate investment strategies or excessive fees for the client.

To circumvent this situation, this proposal bans product providers from issuing monetary and non-monetary (ie soft dollar) benefits and from licensees and authorised representatives from accepting them.

However, there are exceptions to when the ban applies as follows:

Exceptions on monetary benefits

- Employers paying employees' salaries;
- Fee for service paid by a product provider to the adviser;
- General insurance (eg home, contents, car);
- Life insurance (excluding group policy insurance within super);
- Individual life insurance policies for members exercising choice of fund; and
- Execution-only (non-advice) services.

Exceptions on non-monetary (soft dollar) benefits

- General insurance (eg home, contents, car);
- Benefits of up to \$300* which are not identical or similar and not provided frequently or regularly;
- Benefits for Professional Development;
- Benefits for IT software or support; and
- Execution-only (non-advice) services.

**Amount still to be confirmed.*

As you can see, general insurance and non-advice services are exempted as conflicted remuneration for both monetary and soft dollar benefits. However, commission on group life insurance within super is banned, as is commission on personal life insurance attached to the default super fund (and MySuper products from 1 July 2013).

What does this mean for you?

This proposal won't make any difference to AXIS clients, as our Servicing Agreements are based on a fee-for-service model with agreed Key Performance Indicators. However, corporate super funds using other advisers might not be so lucky.

Further underinsurance problems

If commissions are banned on group insurance policies within super, many advisers might not be willing to provide insurance as part of their service offering. This could exacerbate Australia's massive underinsurance problem and leave many super fund members without a financial safety-net in the event of death, disablement or illness.

Higher costs

As an employer, corporate funds could find themselves more out of pocket if advisers increase overall fees to compensate for the loss of insurance commissions.

At an employee level, individual insurance policies are generally more expensive than group insurance policies. Although personal policies within super

are usually cheaper than those outside of super, employees will still be slugged with higher premiums.

However, there may also be a positive to this proposal.

Improved servicing levels

If advisers can receive commissions on individual policies for members exercising super choice, we could see more advisers actively servicing their clients. This would be good news for super fund members and the industry. In our experience, underservicing is usually the main cause of low member account balances and why many Employers switch to utilising the services of AXIS Financial Group.

Naturally, we should remember that any potential negative outcomes of this proposal are just that – potential. Particularly given that licensees and authorised representatives are expected to adhere to the Best Interests Obligations at all times!

II. Other banned remuneration

Commissions will also be banned on two other key areas – volume-based shelf space fees and asset-based fees on geared funds.

Ban on volume-based shelf space fees

This proposal bans commissions being paid to platform operators based on the total number or value of financial products (ie the “volume-based” part) that are listed on an administrative platform (ie the “shelf space” part). By banning commissions to platform operators, this proposal aims to improve transparency of fees.

What does this mean for you?

Again, AXIS clients won’t be affected by this proposal as, importantly, we are not tied to any product provider. Our advice to you and your employees is based on the products which offer the best solution for your super fund. Ultimately, as our client, you receive non-aligned advice at all times.

However, this proposal is vague in its use of terminology and lack of definitions, which could detract from achieving its objective. There is no definition of the term insurer, which means that

not every company conducting insurance-related business will be captured by the legislation. The obvious name that springs to mind is Lloyd’s of London – the insurer of insurers. Lloyd’s doesn’t operate as a company, but rather a syndication of individuals and managing agents. Hence, where would they fit in the application of the FOFA legislation?

The definition of “platform operators” is also fuzzy and doesn’t appear to capture brokers, who can seemingly continue to receive volume-based payments.

There is also no specific exclusion relating to licensees who employ insurance advisers. So, while general insurers are excluded in the ban on conflicted remunerations, an employer paying their insurance advisers commissions on products sold could be in breach of the legislation.

For obvious reasons, industry has asked the Government for clarification on this proposal.

Ban on asset-based fees on geared funds

Geared funds are borrowed monies. This proposal bans commissions being paid on the amount of assets used to purchase a financial product, if those assets are borrowed. Naturally, financial advisers would be expected to make all necessary enquiries as to the source of the funds.

What does this mean for you?

This proposal is unlikely to have any impact on corporate super funds as we do not use gearing strategies for your superannuation.

A bit about scaled advice

An important offshoot of FOFA that the Government hopes to introduce once the FOFA Bills are passed is the implementation of “scaled” or limited advice. According to their research, one third of Australians would prefer access to “piece-by-piece” superannuation advice (e.g. selecting an investment strategy or consolidating super) rather than receiving advice about their overall financial affairs. By introducing scaled advice, the Government hopes

to improve accessibility to financial advice and make advice more affordable for more people – one of the main objectives of FOFA.

ASIC is currently in the process of updating Regulatory Guide (RG) 200 – Access to advice for super fund members, which provides guidance on the boundaries between factual information, general advice and personal advice and how to impart it. The new RG is due out in November 2011 with an update scheduled in 2012, to ensure its encapsulation of the FOFA reforms. If you'd like more information about scaled advice, you can download ASIC's Consultation Paper 164, Report 224 and Regulatory Guide 200 at www.asic.gov.au

What does scaled advice mean for you?

Scaled advice will allow your employees to obtain personal financial advice about a specific area to do with your corporate super fund. This is fine, if the query is simple. For example, how to nominate a beneficiary. However, if the query is more complex, we believe scaled advice could be risky. From AXIS' point of view, it potentially contravenes the provision of quality financial advice and the outcomes we strive to achieve for our clients.

ASIC Consultation Paper 164 – Additional guidance on how to scale advice, indicates that advisers won't be allowed to discuss any other arrangements that your employees might have with another super fund. For example, if an employee called us to discuss their insurance, we would only be allowed to provide advice on their arrangements with you and not be able to advise on, say, a personal policy or insurance they have with another fund. This could result in negative consequences, such as inferior arrangements or additional expense, if a member doesn't fully investigate their options. It's also more time consuming for the member.

For this reason, we're further advocating the importance of our 30 Minute Sessions in the lead up to FOFA. These sessions are dedicated to specific topics for employees at different stages in their lifestyle and membership. They provide an informal opportunity for employees to ask questions and obtain full, personal advice about their circumstances.

Any queries?

If you'd like more information about the FOFA draft legislation, visit www.futureofadvice.treasury.gov.au

If you have any queries about FOFA and its impact on your super fund, AXIS Financial Group would be happy to help. Please contact your dedicated Corporate Adviser, our Advisory Group or Technical Services team on (08) 9426 5800 or 1800 111 299. Alternatively, you can email us at advice@axisfg.com.au

References:

- ASIC Media Release 11-152, ASIC consults on how to scale advice, July 2011.
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Feel free to contact your adviser with any questions about this edition of Super Focus



Phone 08 9426 5800 Fax 08 9426 5850
Freecall 1800 111 299 Email advice@axisfg.com.au