



GATEWAY INSIGHTS

December 2011

26 FOFA - an update on what, why and who is influencing this impending legislation...

Where we are at.....

2011 has again been an extraordinary year in financial services. Amongst the backdrop of continued world investment market uncertainty here in Australia we have seen the proposed legislation for the Future of Financial Advice (FOFA) tabled in parliament with a 2012 deadline fast approaching. With other Labour Government priorities we would be surprised if the FOFA legislation is all done and dusted by July next year and in fact expect that it will take the whole of 2012 to resolve as there is still a large amount of uncertainty surrounding many aspects.

Proposed FOFA changes have been met with both positive and negative feedback from industry participants, most notably the Financial Services Council (FSC) and the Financial Planning Association of Australia (FPA). As many of you know, the FSC is the advocacy body representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks.

There are many changes on the horizon that are encompassed by FOFA – these include MySuper, Opt-In, StrongerSuper, SuperStream, Best Interest Duty and potential changes to ASIC powers. In this Insight we thought it would be useful to summarise all of the above and what the implications might be for fund managers combined with the views of the key industry bodies involved, the FSC and the FPA.

What does the Future of Financial Advice (FOFA) include?

- 16 key elements to the FOFA legislation
- Key elements include:
 - Codification of a Best Interest Duty - requiring advisers to place the interest of the client's before their own

- Conflicted remuneration structures – banning of commissions (super and investments), volume payments and soft dollar payments which might reasonably conflict financial advice /financial product recommendations
- Opt-in – requiring clients to pro-actively confirm they wish to keep receiving financial advice and paying ongoing advice fees, every two years
- Scalable advice
- Intra fund advice
- ASIC powers
- The new legislation is a lot harder than first thought to draft for various reasons. For example, there is no definition of “rebate” in the Corporations Act so how do you ban something that doesn’t exist?
- Below we explore in more detail some of the more contentious parts of FOFA and what the different views in the market currently are.

Best Interests Test

- There seems to be general agreement that the Best Interests Test will focus on the conduct and the quality of advice delivered rather than the outcomes of the advice.
- The Best Interests Test spells out that a financial planner will be expected to:
 - ✓ Act in the client’s best interest; and
 - ✓ Take reasonable steps to consider a range of products when making a product recommendation; and
 - ✓ Prioritise the interests of the client above those of themselves, their licensee and other related parties; and
 - ✓ Give appropriate advice¹.
- While the “reasonable steps” defense will mean that they do not need to consider every product on the market, they cannot exclude whole classes of product. So if approved product lists do not include a reasonably broad range of product types, planners will have to refer on clients whose needs they cannot satisfy.
- However, the new duty does not:
 - Define what acting in the client’s best interest means,
 - There is no reasonable steps defence; and
 - No ability to limit the scope of the subject matter
- *John Brogden, Chief Executive of the FSC has said with regards to the Test that “it undermines a core objective of the FOFA reforms – to increase the availability and accessibility of advice”². He*

¹ <http://www.professionalplanner.com.au/magazine-2/the-best-interests-test/>; David Whitely, Chief Executive, 1/12/2010

² Money Management; December 1st 2011 “FOFA tranche contains unintended consequences” by Mike Taylor, page 3

goes on to say “the FSC supports a best interest duty; however the legislation will create unprecedented uncertainty for consumers and advisers. The best interest duty is the foundation of the entire reform package and without a clear and objective measure to test whether an adviser has acted in the best interests of their client, advisers will be exposed to significant risk and the cost of advice will go up”. Clearly not the outcome the reforms are trying to achieve.

- *The FPA on the other hand are broadly supportive of the test (they still have some concerns over insurance and soft dollar payments proposed legislation).*

SuperStream

- SuperStream is a proposed measure for dealing with the situation in which superannuates have multiple accounts for no good reason.
- The key focus of the reforms is the rationalisation and consolidation of multiple superannuation accounts.
- Issues that need to be considered:
 - Need for an Opt Out mechanism – if there is no reply back should accounts just be consolidated anyway?
 - *ASFA and the FSC prefer an Opt In basis where fees, performance and risk should all be addressed and also the introduction of a threshold amount eg. \$1000 or greater could ensure you receive minimum insurance protection.*

Stronger Super (MySuper)

- Stronger Super is a Federal Government initiative aimed to make Australia’s superannuation system stronger and more efficient and to help to maximise retirement incomes for members.
- Specifically, the Government will:
 - ✓ create a new simple, low cost default superannuation product called 'MySuper';
 - ✓ make the processing of everyday transactions easier, cheaper and faster, through the 'SuperStream' package of measures; and
 - ✓ strengthen the governance, integrity and regulatory settings of the superannuation system, including in relation to self-managed superannuation funds³.
- All investment managers can offer a MySuper product as long as it is compliant to the requirements of MySuper (a balanced fund option essentially).
- *The FSC are basically comfortable with MySuper and but see a risk in there potentially being too much of a focus on costs over net returns.*

³ Federal Government website for StrongerSuper

<http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm>

Opt-In

- This is a duty for financial advisers to confirm with clients, every two years, if they want to remain as ongoing fee paying clients.
- *The FSC's view is that the Opt-In is unnecessary and redundant given the FOFA proposition of the Best interest duty and banning of commissions.*
- The biggest issue with Opt-In is the Government needing to gain support of key independents Rob Oakshott and Andrew Wilkie to support the key amendments. This is because there have been a large number of financial planners, concerned about the Opt-In legislation and the effect that it will have on their business, who have been lobbying Oakshott and Wilkie.
- *The FPA and the Association of Financial Advisers (AFA) are united in opposing the Opt-In legislation.*
- Opt In will not apply if there are no ongoing fees being received.
- Opt-In also does not apply where a super trustee offers "intra-fund advice" which is paid by the client's super administration fee.

ASIC powers

- ASIC believe they have had their hands tied in the past on certain issues and are asking for an 'extension' of powers specifically around licensing and financial advisers.
- The new legislation will mean they can refuse an application for an AFSL if they see fit.
- *The FSC is opposed to this legislation as they believe some dealer groups could be unfairly treated.*

Conflicted remuneration structures

- These structures include commissions and volume payments, in relation to the distribution and advice of retail investment products including managed investments, superannuation and margin loans.
- *The ban on conflicted remuneration (commissions) on super funds is consistent with the Superannuation Member Charter the FSC issued in 2009.*
- Under the second tranche of FOFA some financial planning groups will have scope to prove that some volume rebate arrangements are not conflicted.
- *The FPA supports the measures to ban soft dollar benefits as they are in line with existing joint FPA/FSC standards. The only issue the FPA disagrees on is support of conferences being predicated on location – referring to conferences and professional development activities. If the event is legitimate then location should not matter Mark Rantall, Chief Executive of the FPA has said.⁴*

⁴ Money Management; 1st December 2011; "Second tranche gives scope to argue on volume rebates" by Mike Taylor, page 5.

Key takeout's from this Insight

- There is still considerable uncertainty around all FOFA changes.
- These are unlikely to be resolved until the end of 2012.
- For fund managers, banning of commissions and volume related payments means that your products are likely to receive more air time (all things considered) and be recommended to the appropriate end investors.
- The introduction of the low-cost MySuper investment option will unfortunately continue to focus attention on fund management fees.
- All of these changes are going to make the industry even more highly regulated and competitive in a global sense. Hence the role of gatekeepers will be more important than ever.
- The focus of the introduction of FOFA and the objective of the Australian government in introducing this legislation is in duty of care to the client. It is likely that investment management best practice will continue down the same path. For the investment management community this might translate into thinking about whether your investment practices are all in the client's best interests, can tax implications be considered; or how your product is likely to be utilised by your clients – is it appropriate for a portfolio approach to investing or is it more suitable as a standalone product. Is the benchmark appropriate for the end client?
- As investment managers and as financial planners, as research houses and consultants we are all guardians of the client's money. FOFA is likely to provide focus to that guardianship.

About Gateway

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway's services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Australian financial services market.

Our qualifications

Amanda has over 20 years' experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 15 years' experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.

