

The Truth about FoFA

The following is the Financial Services Council's analysis based on what is covered by the law and in government policy statements.

ISA's proposition	FSC's Interpretation of Law/Policy Statements
<p>Allowing conflicted remuneration to be earned by staff giving general financial advice. The exemption has broad application to advisers and other staff working for banks, their subsidiaries and any licensee selling an in-house product. This would permit incentives to drive mis-selling of complex products, given that basic banking products are already completely exempt (made by regulation with effect from 1 July 2014 until 31 December 2015)</p>	<ul style="list-style-type: none"> • Commissions and conflicted remuneration are banned by FoFA. • The Government's amendments do not allow commissions nor conflicted remuneration to be earned nor paid to employees even those who only provide general advice. • FoFA does allow employees to earn a salary and incentives but not commissions for product pushing. FoFA law today allows for some of these incentives. <p>Remember many employees are NOT financial planners, do not hold themselves out to be financial planners and some are even remote from consumers but may still fall within the definition of banned payments (for example a fund manager's web designers, product managers that put a product offer document to market, a superannuation call service employee and a bank customer service employee) – the general advice exemption allows these employees to be remunerated as they were never intended to be caught by FoFA.</p>
<p>Allowing commissions on execution services, even when personal advice has been provided to the client by another representative (made by regulation with effect from 1 July 2014 until 31 December 2015)</p>	<ul style="list-style-type: none"> • FoFA bans all commissions (except those grandfathered for a time). • MySuper Law also bans commissions on MySuper. • FoFA law pre and post the Government's amendments do not permit a Licensee nor an adviser to earn a commission therefore they can't share a commission for execution only services. • If a client had sought personal advice from a Licensee or representative of that Licensee then seeks to have someone else action that advice for them from the same business in a 12 month period – no one in that business can earn a benefit, monetary or otherwise which is conflicted remuneration.
<p>Allowing ongoing asset based fees to be paid on an indefinite basis, even if no ongoing advice provided (made by regulation with effect from 1 July 2014 until 31 December 2015)</p>	<ul style="list-style-type: none"> • The Government has not made any amendments to the provisions governing ongoing asset based fees. • Advice clients paying asset based fees are generally engaged with their advisers, have entered into a contract/agreement to pay their adviser in that particular manner and receive a number of regular statements from their adviser and the product they are invested in to inform them of exactly how much they are paying in advice fees.

<p>Allowing banks to pay commission-based bonuses to their financial planners via 'balanced scorecards' to incentivise product sales (made by regulation)</p>	<ul style="list-style-type: none"> • Commissions are banned (therefore even the creatively titled commission based bonus is banned). • All advice must be in the client's best interest. • The adviser must prioritise the client interest before themselves and any third party. • Any incentive paid to an employee via a balance scorecard even remotely related to advice must be low (law says up to 10% of the scorecard only can apply to this measure). <p>Example</p> <p>Employee's salary is \$50,000. Employee's total performance bonus is \$1,000. The amount of remuneration in the performance bonus that would otherwise be considered conflicted remuneration, apart from the performance bonus exemption, is \$100. The "low" test is calculated by $\\$100/\\$51,000 = 0.20\%$. Which means the "low" test is satisfied because the remuneration that would otherwise be conflicted (the \$100) is less than 10% of the employees total remuneration. The remuneration must still meet the other requirements of the provision, and ASICs regulatory guidance.</p>
<p>Extending grandfathering so commissions can be traded (made by regulation)</p>	<ul style="list-style-type: none"> • Hon Bill Shorten confirmed that the new FoFA laws would ban conflicted remuneration but would allow a business, which many financial advisers are (small business people), the right to continue to earn monies on their business pre FoFA's start date. This is called Grandfathering. • The Government's amendments simply allows an adviser (usually an independent small business person who has franchised their licensee from a Licensee) to move around in the market to ensure their Licensee is best placed to support their clients and business. • Specifically, the amendments to the grandfathering provisions allow an adviser to continue to receive benefits that would have been grandfathered had the adviser not moved licensee. • There is no expansion in rights of benefits – merely the right to change Licensee and retain the grandfathering rights.

<p>Permitting commissions where the client takes up a new pension product (made by regulation)</p>	<ul style="list-style-type: none"> • Commissions are banned by FoFA. • The Government's amendments do not permit commissions to be paid on the commencement of any new consumer accounts including pensions. • Best Interest duty and priority rule continue to apply to ensure that advisers puts the client's interest before theirs including ensuring the adviser ensures the client is recommended products, pension or otherwise which is in the client's best interest. Consumers also receive fee disclosure from their super/pension fund showing what if any advice fees are paid (including any grandfathered commissions).
<p>Allowing commission-based bonuses to be paid on 'permissible revenue' (made by regulation)</p>	<ul style="list-style-type: none"> • Commissions (and commission based bonuses) are banned by FoFA except where grandfathered. • The Government's amendments do not allow new volume bonuses to be paid nor passed onto new advisers. • Each benefit must pass the FoFA Conflicted remuneration test. A payment received by a planner may not be paid (passed on) to another adviser unless the payment is also not conflicted in the hands of the second planner. It is difficult to see how a payment received for execution by one planner could pass the conflicted remuneration test and be passed on to a second planner. • However, given the law is written so the Licensee is legally the recipient of advice fees such as execution only services, the Government's amendments do allow the legal recipient (the licensee) to pass on the fee the client paid to the adviser who provided the services (because the law does not permit the adviser to actually be the fee recipient). Demonstrating that the amendments are technical amendments to ensure that FoFA law works efficiently and as intended.
<p>Allowing banks to pay wholesale commissions to advisers based on sales volume (volume rebates) (made by regulation)</p>	<ul style="list-style-type: none"> • The Government's amendments simply clarify the operation of the ban on volume based shelf space fees. • The Government's amendments do not allow new volume bonuses to be paid.

Table 2: Summary – Country comparison of financial advice regulations¹

AUSTRALIAN Requirement	Indicative comparisons				
	Canada	Hong Kong	Singapore	UK	USA
Licensing requirements					
Organisation requirements – Must hold Australian Financial Services Licence and meet obligations on governance, organisational competence, risk management, financial capital, technology, human resources, insurance and disclosure.	● Comparable	● Comparable	● Comparable	● Comparable	● Less
Individual adviser requirements – Must hold Diploma Financial Services qualification, relevant accreditations and maintain annual Continuing Professional Development.	● Comparable	● Comparable	● Comparable	● Comparable	● Less
Statutory duties					
Client centricity – Must demonstrate client's best interest and demonstrate compliance with safe harbour steps.	● Less	● Less	● Less	● Comparable	● Less
Disclosure requirements					
Must provide Financial Services Guide to client prior to giving advice.	● Comparable	● Less	● Comparable	● Comparable	● Comparable
Must document client objectives, financial circumstances, recommendations, alternatives considered, risks, fee and conflict disclosures (usually in a Statement of Advice).	● None	● None	● None	● Less	● None
Must provide Fee Disclosure Statement on annual basis where ongoing services are provided to review clients.	● None	● Less	● None	● Less	● None
Conflicted remuneration prohibitions					
Ban on remuneration and benefits that could reasonably be expected to influence the financial product advice given.	● None	● None	● None	● Comparable	● None
Conflict of interest requirements					
Further to the statutory duty to prioritise client interests, required to manage conflicts of interest through either controlling and avoiding or disclosing.	● Comparable	● Less	● Comparable	● Comparable	● Comparable

¹ Deloitte (2014), *A comparison of financial advice regulations – personal advice for retail clients*. p.g.8.

TABLE 3: Remuneration practices	Are these payment allowed under current FoFA law?	Are these payment allowed under proposed amendments?
Upfront commissions²	- No - Yes – on insurance outside super.	- No - Yes – on insurance outside super
Trail commissions³	- No - Yes - on insurance outside super. - Yes - Grandfathered for accounts opened prior to 1 July 2014. - Yes - via Intra-Fund Advice on Super ⁴	- No - Yes - on insurance outside super. - Yes - Grandfathered for accounts opened prior to 1 July 2014. - Yes - via Intra-Fund Advice on Super ⁵
Fee for Service	- Yes	- Yes – have been clarified so there is no doubt.
Ongoing Asset based fees (other than borrowed monies (leveraged amounts))	Yes ⁶	Yes
Volume based rebates on borrowed monies (leveraged amounts))	No	No ⁷

² Commission is now defined in the law (in the general advice exemption provision). It is an industry term to describe advice payment made by a product manufacturer (that is, by a Super Trustee, a managed investments Responsible Entity and/or the Insurer of an insurance policy) to a financial adviser/planner on the purchase of the product by the adviser's client. The commission fee is build into the product and can usually be negotiated by the client and adviser (to reduce the fee to zero). An upfront commission is paid on the purchase of the product – its one off. Pre FoFA, average upfront commissions ranged from 0 to 4%. A trail commission is paid ongoing – until the client closes the account or ceases the advice service with the adviser. Pre FoFA, average trail commissions averaged from 0 to 0.4% pa.

³ Ibid.

⁴ The previous government recognised that general and limited personal advice should be able to be provided to members of a super fund and should be collectively charged across the super fund to be on paid to a financial adviser and/or employee of the super fund for providing advice to the super fund's member. This was introduced in the third tranche of MySuper Bills Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012. These payments are called Intra-Fund Advice, are not required to be disclosed to the superannuation member nor can the superannuation member Opt-out of paying these fees even if they do not access the advice. The fee is ongoing whilst the member is in the fund and charged and disclosed as an "administration fee".

⁵ The proposed amendments do not introduce/permit new trail commissions to advisers for personal advice.

⁶ The current FoFA law permits asset based fees except on borrowed (geared) monies – section 964D.

⁷ Subdivision B section 964 of the Corporation Act applies to both general and personal advice and is not being amended by the proposed amendments to FoFA. The Act defines an "asset-based fees" to be any fee for providing financial product advice that is dependant upon the amount of funds (which includes 'volume') to be used to acquire the financial products (section 964F of the Corporations Act).