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The Future Of Financial Advice (FoFA) – Catalyst Overview

On the 28th April 2011, Bill Shorten, Minister for Financial Services and Superannuation, announced more detail regarding the government's response to the PJC Inquiry into Financial Products & Services.

The following is a brief overview of this document, titled **The Future of Financial Advice 2011**¹, as well as some brief views of our own in regards to the areas of impact for AFS licensees who provide client advice - [the Catalyst view is shown in blue text](#).

I have included the table from the Minister's Information Pack at the end of this document, as it sets out the scope of the application of the reforms.

Summary of Reforms

1. Application of the Ban on Conflicted Remuneration to Risk Insurance

- A prospective ban on up-front and trailing commissions and like payments for both individual and group risk within superannuation from 1 July 2013.

[Catalyst view – the removal of commissions on risk within super has been on the agenda for some time with the Industry Super funds leading the charge.](#)

[There will be a significant push by industry super funds to increase insurance within super in the future.](#)

[This may create two streams of insurance in the marketplace.](#)

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This may create problems for specialist risk advisers who may be caught between their “statutory best interest duties”, their need to charge fee for service if recommending risk within super (because there are no commissions and they would still like to be paid for their work) and the client acceptance of fee for service for risk advice.

I am still sceptical that a fee for service for risk recommendations will work for small to medium clients.

2. Operation of “Opt-In” Under the Adviser Charging Regime

- A prospective requirement for advisers to get clients to opt-in (or renew) their advice agreement every two years from 1 July 2012.

The document provides an insight into the implementation process for Opt-In :

- The adviser being required to send a prescribed renewal notice no less than 30 days prior to the relevant (two year) anniversary date;
- This notice would outline the fee the client paid in the previous year and a description of the services they received, and fee and service information for the forthcoming year (also alerting the client to the fact that they can opt out at any time);
- If the client does not respond to the notice or opts out, the adviser cannot continue to charge an ongoing advice fee, and nor can the client continue to expect management of their financial arrangements;
- If the client is unresponsive to the renewal notice, the adviser can continue charging the client for an additional 30 day ‘grace period’ after the anniversary date;
- Every second year where no opt-in renewal is required, a disclosure document would be required to be sent in its place, containing the same information normally contained in the opt-in renewal notice (for example, fee information); and
- If a client does not respond to a renewal notice, they are taken to have chosen to opt-out 30 days after the anniversary date, meaning the adviser’s liability for ongoing advice ceases at the point that they can no longer charge an ongoing fee (advisers will still be liable for advisory services already rendered to the client).

Catalyst view – clearly any licensee who generates significant income from ongoing advice will require a good administration system – particularly as client apathy in not responding will cost you money. Your system will need to

- identify clients requiring the two year notice
- identify clients requiring the one year notice
- generate & send the relevant notice
- record client responses

- follow up clients who have not responded
- remove fees for clients who do not Opt-In.
- apply pro rata fees for the 30 day period of grace

It appears that Opt-In does not apply to risk insurance as “Only those advisers intending to charge ongoing advice fees to retail clients need to send the notice”. I do not think that trailing commissions relating to risk (outside of super of course) would be regarded as advice fees.

3. Ban on Volume Payments

- A prospective ban on any form of payment relating to volume or sales targets from any financial services business to dealer groups, authorised representatives or advisers, including volume rebates from platform providers to dealer groups.

“Scope of the ban

For clarity, the ban will include a prohibition on the following payments:

- Any volume-based payment from a product provider, platform provider, or any other entity to a licensee, authorised representative or adviser in relation to distribution or advice for retail financial products.
- Any volume-based payment by the product provider, platform provider or any other entity to the licensee or adviser which is generally conditional on the licensee having large funds under management with the product (except asset-based fees paid by a client to a licensee or adviser);
- Any volume-based payment from licensees to their employee advisers or authorised representatives for distribution of retail financial products, contingent or based on meeting sales targets; and
- Any volume-based shelf-space fees which are paid from the fund manager to the platform provider and from the platform provider to the licensee.”

Catalyst view – the following is the comment we made 12 months ago

this will impact on the industry as some licensee business models rely on volume bonus payments to be profitable. This is likely to see some licensees adjust their model and may see advisers moving to other licensees as well as the merger of licensees in an attempt to gain scale.

Another round of acquisitions by the larger institutions may occur. Particularly vulnerable will be the mid range size licensees.

Smaller, well run licensees (typical Catalyst client) should be able to weather the changing environment and will be well positioned to grow with their added value approach.

You will note the inclusion of payments between the licensee & their representatives.

This ban does not apply to pure risk insurance – so I expect to see the insurance companies to continue to offer volume incentives.

John Brogden, CEO of the Financial Services Council has made a press release on the morning of the 28th April stating that “*Volume rebate arrangements contractually existing before 30 June, 2012 will continue to exist under the Government’s Future of Financial Advice (FOFA) changes, under an agreement with the Government brokered by the Financial Services Council (FSC).*”

He also states that “*it is understood this (the ban on volume bonuses) does not extend to arrangements between fund managers and platforms*”.

If Mr Brogden is correct I would suggest that there will be a flurry of volume bonus arrangements put in place prior to July 2012.

4. Ban on Soft Dollar Benefits

- A prospective ban on soft dollar benefits, where a benefit is \$300 or more (per benefit) from 1 July 2012. The ban does not apply to any benefit provided for the purposes of professional development and administrative IT services if set criteria are met.

Some examples of the operation of the ban (not exhaustive)

Issue	Banned?	Why?
Free or subsidised business equipment or services, such as computer hardware, office rental and commercial software, over \$300.	Yes	These benefits have the potential to influence product selection and decision making.
Access to administrative information technology services, such as software to access a platform or access to a website to place orders	No	So long as it can be shown that the administrative information technology services is relevant and tangible to the licensee's business, this is a benefit that will be permitted as it facilitates access to advice.
Entertainment and gifts over \$300.	Yes	Entertainment and gifts over this threshold may influence advice.
Conferences, seminars and training where a set percentage of time is spent on education.	No	It is important that licensees and representatives continue to increase their professional standards and development, and training can play an important role in this regard.

Catalyst view – this is just a further tightening of the net over payments that may influence product decisions. I expect that product providers will target the technology area to provide additional support

Once again the ban does not apply to risk insurance (outside of superannuation). Does this mean that insurance companies can suddenly recommence offering soft dollar incentives of any amount ?? Based upon this paper, I think so. It seems that the government is not as concerned regarding consumer interests, which is noted as a principal driver behind these reforms, when it comes to risk insurance. I will bet this is adjusted before July 2012.

5. Statutory Best Interests Duty

- The government will consult further with industry to develop legislation to implement this measure

The issues for consideration raised in the document include :

- The Government recognises that the focus of the duty should be on how a person has acted in providing advice rather than the outcome of that action.
- Compliance with this duty will be measured according to what is reasonable in the circumstances in which the advice is provided.
- A person giving personal advice will not be required to broke the entire market or a subset of the market of all available financial products to find the best possible product for the client, unless this service is offered by the adviser or requested by the client and subsequently agreed to by both parties.
- The legislation will provide that a person providing personal advice cannot contract out of this duty. If a person considers that they cannot provide advice that is in the best interests of the client in accordance with the duty, they must refuse to provide the advice.
- Financial liability for any breach of the duty will rest with the relevant providing entity. This means that individual advisers will not be held financially liable for any breach of the duty.

Catalyst view – this is a step back from the “fiduciary duty” that was raised a year ago. There is further consultation required so expect further change in this area, however there will be a standard implemented.

6. Access to Advice

- Expanding a new form of limited advice called scaled advice, which can be provided by a range of advice providers, including superannuation trustees, financial planners and potentially accountants, creating a level playing field for people who provide advice. Scaled advice is advice about one area of an investor's needs, such as insurance, or about a limited range of issues.

Catalyst view – the weird thing about this is that the government believes that the predominant type of advice provided to consumers is holistic advice where an adviser provides advice on all areas to a client. Almost every piece of advice that we see has been limited in some way – so this concept is nothing new.

Catalyst have been advising and assisting licensees to provide limited advice for some time.

There will be a paper issued in June/July this year providing more detail – so we will await further detail.

Of interest will be whether they are just restating what can already be done or whether they actually simplify the provision of advice. Also of interest will be the impact on intra-fund advice and advice provided by accountants.

7. Limited Carve-Out for Basic Products

- A limited carve out from elements of the ban on conflicted remuneration and best interests duty for basic banking products where employees of an Australian Deposit-taking Institution (ADI) are advising on and selling their employer ADI's basic banking products. Basic banking products are basic deposit products (e.g. savings accounts), first home saver account deposit accounts and non-cash payment products (e.g. travellers cheques and cheque accounts).

Catalyst view – simple bank account products should be easily presented to the consumer.

The carve out does not apply when more complex products are involved as well as the basic products.

Interestingly the ban on conflicted remuneration structures and the requirement to act in the client's best interest do not apply here, so bank staff can be paid bonuses for sales volume even if they know there is a better product available

8. Restriction on the Term Financial Planner / Adviser

- The Government will explore whether the term 'financial planner/adviser' should be restricted under the *Corporations Act 2001* (Corporations Act).

Catalyst view – this is a good idea as it will further restrict the “cowboys” from operating and potentially disadvantaging consumers.

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Extract from **The Future of Financial Advice**

Scope of the Reforms

FOFA measure	Description	Scope/application
Ban on conflicted remuneration	A ban on conflicted remuneration structures, including commissions and volume-based payments	Provision of general and personal advice to retail clients
Compulsory renewal (opt-in)	A requirement for advisers to renew client agreement to ongoing advice fees every two years	Provision of personal advice to retail clients
Best Interests Duty	Requirement for advisers to act in the best interests of their clients	Provision of personal advice to retail clients only
Ban on soft dollar benefits	A ban on soft dollar benefits over \$300 per benefit	Includes provision of general and personal advice to retail clients
Basic banking products carve-out	Relief from best interests duty and ban on conflicted remuneration where employees of ADIs are selling their employer’s basic banking products	The carve-out will apply in relation to general and personal advice in relation to the products mentioned