

MALLESONS STEPHEN JAQUES

Client Alert

Reshaping the financial services industry - 27 April 2010

Yesterday the Federal Government announced its "Future of Financial Advice" reforms in response to the Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into financial products and securities in Australia*. The effects on commissions and financial advisers have been widely reported in the media.

This alert focuses on the broader impacts for the financial services industry if the proposed ban on conflicted remuneration structures and the proposed statutory fiduciary duty for financial advisers become law.

The proposed ban on conflicted remuneration structures is described in very broad terms: "all commission payments ... [and] **any form** of payment relating to volume or sales targets ... from **any** financial services business, relating to the distribution and provision of advice for retail financial products".

The proposed ban on commissions is consistent with our expectation at the time of the PJC report's release ([click here](#)).

While the reforms focus on financial advisers and financial advice, they will have knock on effects for the whole retail financial services industry. If they become law, the reforms will significantly change the framework within which financial products are distributed and sold and will pose real challenges for the traditional product distribution model. The decoupling of distribution from advice has the potential to profoundly reshape the industry.

Remuneration ban covers a broader range of products than first expected

The proposed ban will apply to all financial products that are held by retail clients. It will not initially apply to risk insurance. In addition to covering superannuation and funds, this ban will also apply to margin loans, derivatives, shares, debentures, foreign exchange contracts and bank accounts.

Further, asset based fees for advice will only be able to be charged on ungeared products and investment amounts. It appears that asset based fees will not be able to be charged for advice on the geared component of products with imbedded leverage (e.g. geared share funds and some structured products).

A statutory fiduciary duty - clarification, or further confusion?

The Government has adopted the PJC's recommendation to introduce a statutory fiduciary duty and has provided more details about the proposed duty. The Government has clarified that the "financial advisers" to whom the duty will apply are AFS licensees and their authorised representatives. The Government has also stated that there will be a "reasonable steps" defence to an allegation of breach of the duty, as advisers "are not expected to base their recommendations on an assessment of every single product in the market".

However, the Government acknowledges that more work needs to be done in order to fully articulate the scope and content of the duty. A key question is whether the statutory

Who does this affect?

Financial product issuers, platforms, dealer groups, financial advisers and accountants providing self managed super fund services.

What do you need to do?

- (1) Consider how your business (including cash flows) will change as a result of the proposed ban on conflicted remuneration structures. -
- (2) Road test financial product distribution and adviser retention strategies against the proposed changes.--
- (3) Consider new product opportunities and the systems and other practical issues that arise for existing products. --
- (4) Be involved in the industry consultation.

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duty will codify the law in this area. If not, a financial adviser will need to consider both the statutory duty and their general law fiduciary duty, which (going by the Government's description of the statutory duty) will have different implications. Further, it is unclear whether the proposed duty to place the interests of clients ahead of the interests of the adviser is meant to add anything to the proposed duty to act in clients' best interests - and, if so, what it would add.

Finally, the proposition that a statutory fiduciary duty would improve the quality of financial product advice is debateable. The legal requirements that are more directly relevant to the question of quality of advice are, instead, based on the law relating to duty of care and standard of care. We looked at this in more detail in our [December article](#) in Regulator.

Challenges for platforms and product distribution

The proposed ban will extend to "shelf space" charges that are paid from a product issuer to a platform provider where those charges are based on volume. More significantly, platform providers will be banned from making volume based payments to a licensee (such as a dealer group). This will change platform remuneration structures and will drive innovation as platform providers seek to ensure their products remain attractive to dealer groups, advisers and clients.

While these reforms pose challenges to aspects of the traditional platform value proposition, platforms are likely to continue to play an important role in administering aspects of the relationship between advisers and their clients, including calculation and payment of agreed fees.

These issues are discussed further in our [December article](#) in Regulator.

Consequences for product issuers

Product issuers should consider their distribution strategy in light of the proposed reforms and in particular whether to invest more into attracting direct investors.

Product issuers are likely to reduce their fees or cost of their new products by the amount they would otherwise have to pay to advisers (e.g. upfront or trail commissions built into the product). More broadly, product issuers should consider new product opportunities and the systems and other practical issues that arise for existing products.

These issues are discussed further in our [April article](#) in Regulator.

Expansion of simple advice in super

Last year, ASIC provided class order relief for "intra-fund" advice in superannuation. The relief targeted advice about relatively simple, intra-fund matters such as investment options, contributions, insurance and financial hardship, but did not extend to more complex matters such as switching from one fund to another, consolidating multiple super accounts, more complex retirement planning advice, insurance outside a member's fund or how to choose between investing in super and other financial products.

The Government proposes to build on and extend the existing relief, to cover transition to retirement, intra-pension advice, nomination of beneficiaries, superannuation and Centrelink payments and retirement planning generally.

Retirement planning often involves quite complex considerations and strategies. If the relief is extended, appropriate measures should be crafted to ensure that "affordable" advice does not become inappropriate advice.

Reviewing the distinction between wholesale and retail clients

The Government will consult with industry and review the appropriateness of the current criterion under which a client is classified as retail or wholesale. The Government considers that a review of mechanisms for determining whether a client is classified as wholesale or retail is appropriate, to ensure the distinction remains relevant.

Any change to the distinction could have far reaching effects.

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Further information

Click [here](#) for a link to the Government media release announcing the reforms.

Next steps

The majority of the reforms are proposed to commence from 1 July 2012. The Government will consult with industry on the implementation of the reforms. Query whether draft legislation will be released before the Federal election.

This publication is only a general outline. It is not legal advice. You should seek professional advice before taking any action based on its contents.

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