AUSTRALIAN BANKERS' ASSOCIATION INC.

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Mr Bede Fraser
Acting General Manager, Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600
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Dear Mr Fraser,

The Australian Bankers' Association (ABA) appreciates the opportunity to provide comments to Treasury on the exposure draft Future of Financial Advice (FOFA) amendments package – *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* and *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014*.

Opening remarks

The ABA commends the Federal Government for announcing a package of legislative and regulatory changes ("FOFA Amendment Package") to target and improve the application and operation of the FOFA provisions. This package of amendments will ensure that the FOFA reforms reflect the original policy intent of raising conduct and disclosure standards relating to financial advisers and the provision of personal advice as well as minimise unintended and adverse consequences for the offer of basic, retail banking products and the provision of general advice to Australian consumers.

Many bank customers want to interact with their bank in easy, simple and low cost ways across different banking channels. However, the FOFA reforms, despite attempts to address the overreach of the law into retail and business banking, would have substantially impacted on banking making it more costly and less efficient. Many bank customers currently receive free financial information and advice from their bank, and the side effect of the FOFA reforms would have resulted in banks and banking groups being less able to provide these free and low cost products and services.

The ABA supports the policy intent of the FOFA reforms to improve the quality of financial advice, the regulation of financial advisers, and the professionalism of the financial planning industry.

The ABA believes that:

- Financial advice should be accessible and affordable;
- Financial advisers should be part of a trusted profession;
- Consumers should receive personal advice that is in their best interests and have confidence that the personal advice they receive is not conflicted;
- Financial services law should better accommodate the different advisory situations which relate to different types and classes of financial products and support consumers being able to access different forms of advice; and
- Financial services law should not introduce price controls or interfere with remuneration structures within a banking business. Performance benefits and payments between an employer and their staff should be recognised as an important and legitimate part of the workplace.

The ABA welcomed the announcement of the FOFA Amendment Package by the Assistant Treasurer on 20 December 2013[1]. The banking industry has been very concerned about ongoing legal and regulatory uncertainty with some of the FOFA provisions and this announcement, and the subsequent announcement and release of draft legislation and regulations for consultation[2], addresses this uncertainty. We support the approach to execute the package via changes to the legislation and regulations so that legal uncertainty and outstanding technical and practical issues can be resolved as soon as practicable.

The ABA has previously raised industry concerns with the former Government about the breadth of the FOFA provisions, the prescriptive nature of the changes and the lack of interaction between the policy intent and the practical effect of some of the FOFA provisions, especially with regards to the impacts on other parts of the industry, including retail and business banking, and the likely impact on the accessibility and affordability of financial products, financial services and financial advice for Australian consumers. We have also highlighted a number of unintended consequences and practical and technical complexities now evident as the FOFA provisions have been operationalised. Therefore, we also support the package as addressing concerns with the breadth of the FOFA provisions while maintaining higher standards of conduct and disclosure for financial advisers.

Banks and banking groups have already made a significant investment into making the necessary changes to their compliance systems and processes to reflect the new FOFA obligations, which have already commenced. However, despite numerous assurances and claims from the former Government that retail banking would not be impacted by the FOFA reforms, the industry continues to face legal and regulatory uncertainty and the prospect of having to restructure their retail banking businesses and change the way in which they deal with customers and employ their staff.

For example, the FOFA provisions relating to banking and financial products, with its extremely broad prohibition on conflicted remuneration and narrow and distinct exemptions, when combined with the different regulatory framework which applies to credit products, will create unintended consequences for banks, their customers and employees:

- Banks will not be able to implement streamlined retail banking business models and will face complicated legal and regulatory requirements and complex obligations creating additional and unnecessary compliance costs, administrative complexities, and legal and operational risks.
- Customers will face convoluted bank-customer relationships and poor customer experience, as they will not be able to have a meaningful needs-based conversation with a single banking representative about their broader banking and financial needs. (We note that customers do not view their financial needs in terms of different products (e.g. deposit products, general insurance products, etc), which is how the legislation is currently structured with respect to the exemptions.) Less information and simple advice will be available through banks to Australian consumers.
- Employees will face a separation of duties, as the one banker will no longer be able to talk more broadly to a customer about their basic banking and financial needs, which will likely result in limitations on employment structures and segregation of roles of bank staff as well as reengineering of business operations and remuneration arrangements for bank staff.

Importantly, there has been no evidence of any systemic issues with regards to the offer of basic, retail banking products or general advice provided by banks. We believe that it is important to ensure a balance between imposing additional regulation on banks and banking groups and providing protections for consumers. There are numerous legal and regulatory obligations to ensure banks are managed prudently and to ensure banks provide their products and services in a transparent, accessible and responsible manner.

[1] http://axs.ministers.treasury.gov.au/media-release/011-2013/ and http://www.bankers.asn.au/Media/Media-Releases/Media-Release-2013/Bank-customers-to-benefit-from-FOFA-reforms

[2] http://axs.ministers.treasury.gov.au/media-release/002-2014/ and http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=consultation/fofa_amendments/default.htm

Therefore, the ABA is pleased that the Federal Government is amending the FOFA provisions to clarify the application and operation of the law and to ensure that the original stated policy intent and consumer protections are maintained without imposing unnecessary costs and regulatory burden on banks, which would substantially change the way banks offer and distribute basic, retail banking products, and increase the costs of banking for both banks and consumers. We note that the FOFA Amendment Package contains proposed changes that reflect the positions in the Coalition dissenting report (part of the final report on the Parliamentary Joint Committee (PJC) Inquiry into financial products and services in Australia published in February 2012) and address outstanding legal and technical clarifications.

Specific comments

The ABA focuses our comments on those matters that have been an ongoing concern for the banking industry in relation to the FOFA provisions.

The ABA acknowledges the submissions made by the Financial Services Council (FSC) and the Australian Financial Markets Association (AFMA) with regards to other proposed amendments relevant more broadly across the banking and financial services industry.

Implementation and transition

The ABA is pleased the FOFA Amendments Package is being implemented via a combination of changes to the legislation and regulations, with changes in the draft legislation being implemented through regulations as an interim and until the legislation receives Royal Accent. The banking industry has been seeking certainty with regards to the application and operation of the FOFA provisions, and in particular, to retail and business banking.

The proposed amendments will broadly address the banking industry's concerns. However, there are some necessary drafting corrections and there will also need to be certain consequential amendments to ensure the changes are implemented across the legislative and regulatory framework. Furthermore, there will need to be changes to relevant regulatory guidance to ensure there is clear and consistent interpretation for industry reflecting these amendments.

The ABA is also pleased that the Federal Government and the Australian Securities and Investments Commission (ASIC)[3] have confirmed that a facilitative compliance approach will be taken to the FOFA provisions and pending amendments until 1 July 2014. This is essential to ensure that the banking industry does not have to undertake unnecessary changes during this transition period and while the amendments are being finalised.

Definition of basic banking product

A basic banking product is defined in section 961F of the Corporations Act to include a basic deposit product, a facility for making non-cash payments that is related to a basic deposit product, a first home saver account, a facility for providing traveller's cheques, and any other product prescribed by regulations. Additionally, section 12DL of the ASIC Act defines a debit card[4]. We note that this definition is almost consistent with the definition for basic banking products categorised as 'Tier 2 products' in existing regulatory guidance[5]. However, innovation in basic, retail banking products and services means that this definition is likely to be outdated, similarly, with the existing regulatory guidance. For this reason, there is a regulation making power in this section of the law to address innovation in products that are not already captured in the definition.

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[3] ASIC (2013). *ASIC Update on FOFA. 20 December 2013*. MR 13-355 http://www.asic.gov.au/asic/asic.nsf/byheadline/13-355MR+ASIC+Update+on+FOFA?openDocument

[4] A debit card is (a) an article intended for use by a person in obtaining access to an account that is: (i) held by the person for the purpose of withdrawing or depositing cash or obtaining goods or services; and (ii) a financial product; or (b) an article that may be used as an article referred to in paragraph (a).

[5] *Regulatory Guide 146: Licensing: Training of financial product advisers* [RG 146] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg146-published-26-September-2012.pdf/$file/rg146-published-26-September-2012.pdf

There are a number of basic, retail banking products that have not been included in the definition currently offered by banks through their retail banking distribution channels. For example, banks offer travel money cards as an alternative product to travellers cheques. The purpose of this product is to enable people travelling overseas to access foreign currency while travelling, similar to a travellers cheque. Similarly, the definition does not clearly include bundled products, which include a debit account with a credit facility. Therefore, we believe that the definition should be clarified to include the concept of "functionally equivalent" products and products which include elements of basic banking products and credit facilities. Furthermore, the definition should be amended to align with those products deemed 'Tier 2 products' (and explicitly, adjust the reference to non-cash payment facilities).

The ABA recommends that the definition in section 961F be amended as follows:

Each of the following is a basic banking product:

(a) a basic deposit product;

(b) a facility for making non-cash payments (see section 763D) ~~that is related to a basic deposit product~~;

(c) an FHSA product of a kind mentioned in subparagraph (c)(i) of the meaning of FHSA in section 8 of the *First Home Saver Accounts Act 2008* (first home saver accounts);

(d) a facility for providing traveller's cheques;

(e) any other product prescribed by regulations for the purposes of this paragraph.

Additionally, the ABA recommends that subsection 961F(e) should be used to create a new regulation to explicitly include travel money cards in the definition.

Additionally, the ABA recommends that the Explanatory Memorandum should be amended to:

- Clarify that all types of basic deposit products are included in the definition, including at-call accounts (transaction accounts, savings accounts, cash management accounts) and term deposits (with a term less than 5 years) as well as other types of basic banking products are included in the definition, including first home saver accounts, non-cash payment facilities, and travellers cheques;
- Clarify that basic deposit products associated with a credit facility (e.g. a debit account with an overdraft facility, mortgage offset account) are included in the definition;
- Clarify that "functionally equivalent products" (e.g. travel money cards) are included in the definition; and
- Reinforce that non-financial products (e.g. credit facilities) are not captured by the FOFA provisions.

Definition of employee

An employee is not currently defined in the FOFA provisions despite being referred to in several different sections, including section 961B(3) (modified best interests duty) and section 963D (benefits for employees etc of ADIs), as well as proposed in Regulation 7.7A.12EB (performance bonuses based on volume). Section 961B(3) and section 963D incorporates the concept of agent and employee or otherwise acting by arrangement [with an Australian ADI under the name of the Australian ADI]. The law is intended to ensure that different corporate structure and staffing arrangements do not inadvertently restrict the application of the exemptions.

The ABA notes that *Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure* explains that acting by arrangement, for the purposes of the basic banking exemption, includes:

- Contractors;
- Employees of employment agencies who may be temporarily working for the Australian ADI;
- Employees of a body corporate related to the Australian ADI; and
- Employees of another company who work exclusively for the Australian ADI[6].

[6] *Regulatory Guide 175: Licensing: Financial product advisers – Conduct and disclosure* [RG 175] RG 175.245.
http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg175-published-3-October-2013.pdf/$file/rg175-published-3-October-2013.pdf

This explanation means that all staff – employees, agents and representatives – of the bank or banking group (including franchise arrangements) are included in the exemption.

The ABA believes that this definition and explanation should apply consistently to all FOFA provisions where the concept of employee is used so all staffing arrangements are covered in the exemptions and proposed regulation. This definition and explanation is limited to those working under the name of the employer, not other or wider arrangements. We consider this is consistent with the approach taken in the FOFA provisions and ensures all staff arrangements are captured and treated without disadvantage.

The ABA recommends that Regulation 7.7A.12EB should be amended to:

- Clarify the application to agents, employees and representatives of an employer by amending sub-regulation (2)(a) as follows: "the benefit is given to, or for, a provider who is an agent or employee or otherwise acting by arrangement for an employer under the name of the employer; and"

Additionally, the ABA recommends that the Explanatory Memorandum and the Explanatory Statement, respectively, should be amended to:

- Clarify that acting by arrangement includes: contractors, employees of employment agencies who may be temporarily working for the Australian ADI/employer*, employees of a body corporate related to the Australian ADI/employer*, and employees of another company who work exclusively for the Australian ADI/employer*.

* as relevant to the particular section or regulation.

Best interests duty – general obligation and 'scaled' advice

ABA position: The FOFA reforms should explicitly permit a financial adviser and a client to limit the scope of advice so advisory services can be tailored without creating legal uncertainty for advisers in relation to the best interests duty. Therefore, the ABA supports the proposed amendment to clarify the best interests duty and the provision of scaled advice.

The ABA supports a duty for financial advisers to act in the best interests when providing personal advice to retail clients, to provide appropriate advice, and to give priority to the interests of those clients in the event of a conflict of interest. The duty should clearly define the application of the duty and articulate the elements of the duty. The duty should apply a 'modified best interests duty' (replicating the 'reasonable basis for advice' test and 'appropriateness' test in repealed section 945A and section 945B) for basic banking products and general insurance products and the full duty for personal advice relating to other financial products.

Additionally, the ABA supports reforms to expand the availability of free and low cost, simple advice and improve the accessibility and affordability of financial advice. The provision of accessible and affordable advice is important to ensure that the many Australians who do not have adequate knowledge/skills or information have greater opportunities to access the relevant knowledge/skills or information to assist them make informed decisions about their savings and investment options.

Currently, a number of banks are:

- *Providing personal advice to bank customers*: Personal advice might be the consequence of information provided by a bank teller or bank specialist to the customer or vice versa. However, we consider that consumers do not expect their interactions with bank staff in branches and call centres to be administered or regulated in the same way as financial advice provided by a financial planner. For example, member banks advise that a common frustration for bank customers is when a bank teller is unable to complete a transaction, such as open a bank account, because depending on the situation, the personal advice regime may be triggered. In this instance, the bank customer is required to complete the transaction with a bank specialist or bank customer relations manager.

- *Providing free consumer education and general advice*: Financial information and general advice might be provided via a number of different distribution channels, including via banks' websites, workshops, seminars and presentations, information, marketing documents and materials, newsletters and market reports, etc. Recent policy and developments regarding online disclosure should allow further opportunities for banks to develop innovative ways of distributing financial information and simple advice. However, we consider there are a number of further changes required to facilitate the greater availability of advice on basic, retail banking products and non-product specific advice.

The ABA notes that the best interests duty contained in section 961B(1) requires a financial adviser to act in the best interests of their retail client in relation to the provision of personal advice. In addition to the duty, there are steps set out in section 961B(2) that proves the adviser has acted in the best interests of their client. An adviser must also give appropriate advice (section 961G), warn their client if the advice is based on incomplete or inaccurate information (section 961H), and prioritise their client's interests (section 961J).

However, currently the best interests duty contains a 'catch all' provision (subsection 961B(2)(g)), which makes the steps in section 961B(2) ('safe harbour' of the duty) impractical and unworkable. Additionally, it is unclear whether the duty permits the ability for financial advisers and their clients to scope their advice and comply with the law. The duty does not permit an adviser to act on their client's instructions or permit the client and the adviser to agree on the scope and subject matter of the advice while still acting in the best interests. For example, clarifying the duty and explicitly allowing scaled advice will enable advisers to offer specialised advisory services for clients not seeking a full financial plan and not wanting to pay the associated costs. Similarly, it will enable banks and other financial services providers to offer online advisory services where clients complete an online form with personal information, thereby limiting the advice subsequently provided (i.e. calculator or computer program).

Therefore, the ABA believes that the law should provide legal certainty about the duty and explicitly recognise the provision of 'scaled' advice and that it is not reasonable or necessary for a financial adviser to obtain additional information from their client, or provide more than their client has requested, or to consider other products that might also achieve the client's needs and objectives. For example, bank staff should be able to meet the best interests duty by providing personal advice only on those products offered by their bank or banking group (including subsidiaries) and not be expected to compare products offered by other banks/banking groups, subject to appropriate warnings.

Furthermore, the ABA believes that the law should recognise the provision of advice via non face-to-face models and channels. The implementation of a new scaled advice framework is likely to provide opportunities for industry to tailor and target their advice offerings to the needs of their customers and retail clients and provide innovative advisory services to expand the types of information and advice available for different customers and retail clients.

In the absence of the ability for a financial adviser and/or bank staff and their client to limit the scope of the advice, including agreeing the subject matter of the advice, clients would be unable to select the advice service they want, advisers would face greater difficulty in managing costs of the advice service provided, and AFS licensees will be restricted in developing innovative advisory services which promote accessibility to advice. The inability to scope the advice impedes the ability for banks and other financial services providers to offer scaled advice and discourage innovation and specialisation in the provision of free and low cost, simple advice. Ultimately, the ability for advisers to provide clients with cheaper and/or better access to advice services will be hindered.

The ABA believes that the best interests duty should be clarified to remove the catch all provision and to explicitly allow an adviser and their client to scope the advice to enable scaled advice. These proposed amendments will provide legal clarity without undermining consumer protection or the duty itself. The best interests duty will continue to provide protection against poor quality advice, as financial advisers providing personal advice to their retail clients will be required to provide a retail client with personal advice that is in their best interests (section 961B(1)) and satisfy the steps to prove that they have acted in their client's best interests (section 961B(2)). We consider that this approach will provide legal certainty with the application and operation of the duty and the steps to meet the best interests duty as well as clarify that scaled advice can be provided while complying with the best interests duty. We note that section 961H requires a financial adviser to provide a warning to their client if the advice is based on information that is incomplete or inaccurate, and therefore, there is already a mechanism for the client to be warned. Importantly, the proposed amendments ensure that the best interests duty, appropriate advice obligation, information incomplete or inaccurate warning, and the duty of client priority cannot be avoided.

However, subsections 961B(2)(a) – (c) should not be adjusted in such a manner as to alter the practical application of the modified best interests duty.

The ABA supports:

- Repealing subsection 961B(2)(a) and inserting a new subsection 961B(2)(ba) as follows: "identified the objectives, financial situation and needs of the client that are relevant to the advice sought ~~disclosed to the provider~~ by the client;"
- Redrafting subsection 961B(2)(f) and the repeal of subsection 961B(2)(g).
- Repealing the note in subsection 961B(2).
- Inserting a new subsection 961B(4A). However, the subsection should be drafted as follows:

  Client seeks scaled advice

  To avoid doubt, nothing in subsection (1) or (2) prevents a client and the provider from agreeing the subject matter of the advice sought by the client with the provider and references to advice sought by the client shall mean the subject matter where so agreed.
- Repealing section 961E.

The ABA recommends that the Explanatory Memorandum should be amended to:

- Clarify that the step taken to identify the subject matter of the advice in section 961B(2)(b) provides the ability to enable an adviser and their client to discuss and agree on what advice will be provided; and
- Include that the best interests duty explicitly accommodates the provision of advice being scoped by a person providing online advice, such as via a calculator or computer program. Importantly, the law should be technology neutral and apply across different modes of online advice, including websites, computer programs, tools, calculators, electronic or digital communications, applications on smart phones, mobile phones or tablet computers, video-conferencing, podcasting or webinars, etc. This approach would allow a customer or client to agree that the scope of the advice is limited by using the calculator or computer program, being how these forms of online advice operate in practice.

Best interests duty – 'Tier 2 products'

ABA position: The FOFA reforms should not apply to financial product advice on Tier 2 products (basic, retail banking products). Therefore, the ABA supports the proposed amendment to reduce unnecessary complexity and ensure that the modified best interests duty operates as intended.

The ABA believes that personal advice on basic, retail banking products should not be captured by the best interests duty. The treatment of basic, retail banking products in the law should reflect the fact that:

- These products are simple and well understood;
- The advice situations associated with the offer of these products is simple and straight forward;
- The banks and other financial institutions providing these products already have sophisticated compliance systems and appropriate consumer protection frameworks;
- The expectations of consumers when interacting with their bank and seeking to purchase or obtain advice on these products is they can do so with ease and in ways convenient to them; and
- There has not been any evidence of a market failure in the offer of banking products and services by bank staff.

Therefore, the ABA welcomed the exemptions for basic banking products in section 961B(3) and general insurance products in section 961B(4) as announced by the former Government. The exemptions were intended to ensure that the best interests duty was modified as it applied to basic, retail banking products, replicating the repealed 'reasonable basis for advice' test (section 945A) and 'appropriateness' test (section 945B). However, the banking and general insurance exemptions are not absolute, do not operate seamlessly, and therefore, cause legal, technical and practical issues for the offer of 'Tier 2 products'. Currently, the modified best interests duty is complex and the existing legislative provisions and regulations do not reflect existing retail banking practices and how consumers conduct their retail banking.

Therefore, the proposed amendments are intended to clarify the application and operation of the banking and general insurance exemptions and ensure the various exemptions work seamlessly to ensure banks can continue to operate through their existing retail banking business models and not result in changes to compliance systems or distribution channels.

The ABA supports redrafting subsection 961B(3). However, subsection 961B(3)(b) should be drafted as follows: "the subject matter of the advice sought by the client relates only to the following: (i) a basic banking product; (ii) a general insurance product; (iii) consumer credit insurance; (iv) a combination of any of those financial products;" (noting that the modified best interests duty applies when the subject matter of the advice sought relates to those financial products, however, section 961B(1) is satisfied in relation to advice given on a basic banking product and/or a general insurance product).

The ABA also recommends that the Explanatory Memorandum should be amended to refer to the "modified best interests duty" (not the reduced best interests obligation). This is an important distinction because it is not a reduction of the obligations imposed on banks. The modified best interests duty is intended to replicate the 'reasonable basis for advice' test and 'appropriateness' test which were repealed when the FOFA provisions were implemented. It is important that the provision of personal advice on basic banking products and general insurance products to be suitable and appropriate for a consumer's situation.

Conflicted remuneration – general advice

ABA position: The FOFA reforms should only apply to personal advice provided to a retail client. Therefore, the ABA supports the proposed amendment to remove general advice from the conflicted remuneration provisions.

The ABA notes that the original policy intent of the FOFA reforms was to address concerns raised during the Parliamentary Joint Committee (PJC) Inquiry into financial products and services in Australia about the provision of personal advice to retail investors where there was a risk of retail clients receiving and paying for conflicted advice. However, the scope of the FOFA reforms was extended significantly with substantial implications for the provision of financial product advice across the spectrum of financial products, and in particular, the provision of general advice.

By definition, general advice does not take into account an individuals' needs, objectives or financial situation, and the advice must be accompanied by a "general advice warning" indicating that the advice does not consider an individuals' personal circumstances, and hence they should consider their personal circumstances and the accompanying disclosure documents before making a decision.

General advice has an informative purpose, without including product-specific advice or recommendations, and is often available to consumers through different banking channels not just face-to-face, including call centres, product brochures and marketing documents, websites, workshops, seminars and presentations, newsletters and market reports, electronic communications and digital applications, etc. Bank staff do not get paid commissions, bonuses or payments directly related to the offer or sale of individual products and the provision of financial advice.

The ABA is advised by member banks that only around two in five Australians are seeking financial advice. Many Australians do not seek financial advice because of issues related to affordability and the limited availability of free or low cost, simple advice. Additionally, some Australians living in rural and regional areas face additional difficulties in accessing advice services. Many do not have ready access to financial planners. Banks and banking groups with large distribution models, targeted advisory services, and various channel arrangements are well-positioned to fill this gap in the financial advice market. Australia's ageing population means it is vital that all Australians have access to some form of financial information and advice.

Bank staff can give personal advice on Tier 1 products if they are suitably qualified. However, it should be recognised that bank staff can have conversations with customers (i.e. factual information or general advice) about all types of products, which may assist customers to understand whether they need to see a financial adviser for more targeted or personal advice.

The ABA believes that the breadth of the conflicted remuneration provisions would likely restrict the ability for banks and banking groups to offer innovative advisory services. The FOFA provisions currently capture AFS licensees and bank staff involved in preparing and providing general advice across any channel and in any form. For example, a bank call centre specialist providing free advice to a bank customer who has called their bank seeking some information about the bank's products. Similarly, a customer has logged onto their bank's website to get some generic information about the financial products offered by their bank or other information, such as a market report, where in these instances the customer does not even speak to bank staff.

Therefore, the proposed amendment to the definition of conflicted remuneration in section 963A of the Corporations Act is intended to remove general advice and explicitly apply the conflicted remuneration provisions to personal advice only.

The ABA supports the redrafting of section 963A as follows:

Conflicted remuneration means any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, who provides personal advice ~~financial product advice~~ to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:

(a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients in personal advice; or

(b) could reasonably be expected to influence the personal advice given to retail clients by the licensee or representative.

The ABA notes that additional sections continue to refer to "financial product advice" and, therefore, cause confusion about the removal of general advice across the FOFA provisions. Therefore, we recommend that all references in the conflicted remuneration provisions should only relate to personal advice (for example, section 963B and section 963D). If these consequential amendments are not made, this would cause legal uncertainty as to the removal of general advice.

Conflicted remuneration – 'solely issue'

ABA position: The FOFA reforms should not prevent a benefit being paid to bank staff relating to excluded products. Therefore, the ABA supports the proposed amendment to ensure that the banking exemption operates seamlessly with all exempt products and situations and in combination.

As with the best interests duty, the ABA believes that financial product advice on basic, retail banking products should not be captured by the conflicted remuneration provisions.

Therefore, the ABA welcomed the exemptions for certain products and situations as announced by the former Government. The conflicted remuneration exemptions for certain products and situations were intended to ensure that the conflicted remuneration provisions did not capture the offer of basic, retail banking products. However, the exemptions are unclear as to whether remuneration on exempt products or situations can continue to be deemed non-conflicted remuneration if information or advice is provided on more than one of those exempt products at the same time, i.e. in combination.

In practice, banks with retail banking distribution channels provide information or advice on other products at the same time or in any combination reflecting customers' interests and needs. For example, a customer wants to buy a property. A customer walks into a bank branch to have a conversation with a home loan specialist about securing a mortgage for a property with a simple mortgage offset account. At the same time, the customer may also be setting up a simple transaction account to manage their cash flow. The banker may also discuss with them the risk of something unexpected happening that prevents them from making the repayments on that loan and how consumer credit insurance can mitigate this risk. Today, this conversation naturally flows under different business models, including factual information, general advice and personal advice models.

In the absence of these amendments, banks may be forced to restructure their retail banking businesses and product offerings or impose unnecessarily complex compliance structures and/or impose employee service restrictions (i.e. frontline bank staff only being able to provide information or advice on basic banking products, general insurance products and non-financial products, or only able to provide advice on general insurance, life risk insurance (including consumer credit insurance), and non-financial products). This demarcation of staff roles would have adverse implications for customer service and employees career pathways.

Therefore, the ABA believes that the exemptions should operate seamlessly and ensure that payments and benefits exempt from the conflicted remuneration provisions remain exempt in combination. Amendments will need to be made to relevant legislation and regulations, and in particular, as changes are to be made initially by regulations.

The ABA supports:

- Redrafting subsection 963B(1)(a) and subsection 963C(a) to omit the word "solely" in relation to monetary and non-monetary benefits relating to general insurance.
- Repealing and substituting section 963D. However, subsection 963D(c)(iii) should be redrafted as follows: "consumer credit insurance; and". Subsection 963D(d) should be redrafted as follows: "the licences or representative does not, in the course of recommending any, or any combination, of those products give personal advice that does not relate to any of those financial products." As noted above, this subsection is inconsistent with the removal of general advice from the conflicted remuneration provisions, and therefore, for avoidance of doubt, it should only relate to personal advice. This subsection also conflicts with the mixed benefits amendment. Retaining this subsection without amendment means that bank staff would be prevented receiving any benefits or payments (relating to exempt products) if they provided information or general advice relating to other financial products (also exempt circumstances).

Furthermore, the ABA believes that Regulation 7.7A.12H should be redrafted as follows:

A benefit is not conflicted remuneration if:

(a) to the extent that the benefit is given in relation to financial product advice, the benefit only relates to the following financial products:

(i) a basic banking product;

(ii) a general insurance product;

(iii) consumer credit insurance;

(iv) any combination of those financial products; and

~~(b) the provider does not, at the same time, provide advice about any other financial products; and~~

(b) the provider is:

(i) an agent or an employee of an Australian ADI; or

(ii) otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI.

The ABA believes that the Explanatory Memorandum should be amended to clarify that the proposed amendments to the exemption from the ban on conflicted remuneration for basic banking products is intended to ensure that the existing exemptions are combined so that bank staff are able to continue to provide information and advice about all basic, retail banking products ('Tier 2 products') as they do now. This change is not broadening the range of circumstances, but is making sure the existing exemptions operate seamlessly, and therefore, avoid arbitrary distinctions across products classes.

Conflicted remuneration – permissible revenue

ABA position: The FOFA reforms should be clear and permit the on-payment of excluded benefits.

The ABA believes that new Regulation 7.7A.12HA clarifies that on-payment of a non-conflicted benefit and/or an excluded benefit is permitted. Once a benefit is not conflicted remuneration or exempt it should remain exempt and permissible, and therefore, should not need to be retested when being passed on to agents, employees or representatives. We consider that this regulation may need further clarification to ensure it does not interfere with the pass-through or grandfathering provisions. (We note the comments made by the Financial Services Council (FSC) and the Australian Financial Markets Association (AFMA)).

Given that Regulation 7.7A.12HA does not relate to basic banking and general insurance products only or mixed advice, we suggest that this be renamed Regulation 7.7A12J to avoid confusion with the intent, application and operation of the provision.

The ABA supports new Regulation 7.7A.12HA (but called Regulation 7.7A12J) as follows:

Benefits calculated by reference to another benefit that is not conflicted ~~remuneration or grandfathered~~

A benefit is not conflicted remuneration if the amount or value of the benefit is calculated by reference to another benefit:

(a) that is not conflicted remuneration; or

(b) to which Division 4 of Part 7.7A of the Act does not apply; or

(c) a combination of (a) and (b).

Conflicted remuneration – mixed benefits

ABA position: The FOFA reforms should permit bank staff being able to provide information and general advice on other financial products at the same time as receiving benefits in relation to exempt products or circumstances. Therefore, the ABA supports the proposed amendment to clarify that the exemptions from the ban on conflicted remuneration allow a benefit to relate to more than one exemption.

The ABA believes that bank staff should not be prohibited from receiving monetary or non-monetary benefits relating in whole or part to an exempt product or circumstance if they also provide information, assistance or advice on other exempt financial products or non-financial products at the same time. Currently, the banking exemption is limited due to the mixed benefits restriction.

The intent of the proposed amendment on mixed benefits is to ensure benefits and payments can be made relating in whole or part to exempt products and circumstances, and paid together, however, to give this effect some drafting corrections are needed. The regulation should deal with separate benefits and components of benefits. In practice, this means that no identification or segregation is required where the components of the benefit are all exempt.

For example, if a benefit relates to basic banking products, general advice on other financial products and the bonus is paid subject to a balanced scorecard approach, the proposed amendment will not assist as the benefit is unable to be segregated into the separate components. Without this amendment, the changes to the basic banking exemption will not operate correctly.

The ABA does not support repealing and substituting Regulation 7.7A.12I. Instead, existing Regulation 7.7A.12I should be retained and clarified so that (2) does not stop the operation of (1) entirely.

Furthermore, (3) should be amended to add section 963D as a prescribed provision (noting this was intended and it is assumed to be an oversight).

Additionally, the ABA recommends that a new Regulation 7.7A.12IA be added as follows:

Mixed benefits

A benefit is not conflicted remuneration does not become conflicted remuneration only because it is given with another benefit.

Sub-regulation 7.7A.12.H(b) should also be deleted as it conflicts with the mixed benefits regulation. (We understand that 7.7A.12H will be deleted in its entirety once section 963D is introduced.)

Conflicted remuneration – performance benefits

ABA position: The FOFA reforms should explicitly permit the payment of performance benefits subject to a balanced scorecard approach. Therefore, the ABA supports the proposed amendment to reiterate the Explanatory Memorandum and Regulatory Guidance and ensure legal uncertainty is addressed with regards to performance benefits for employees.

The ABA believes that bank staff should not be prevented from receiving performance benefits subject to a balanced scorecard arrangement. The existing law is uncertain as it establishes a presumption that a benefit is conflicted if it relates to value or number of financial products (section 963L) and could reasonably be expected to influence the advice (section 963A).

Therefore, the former Government amended the Explanatory Memorandum[7] to provide some explanation of the policy intent of the application and operation of the law so as to:

- Provide industry with the flexibility to maintain broadly based performance-based remuneration arrangements;
- Recognise that performance pay is an important part of any remuneration arrangement; and
- Accommodate certain performance criteria arrangements (i.e. balanced scorecards).

The Explanatory Memorandum states:

> The structure of the ban on conflicted remuneration recognises that employees in the financial services industry are remunerated in a variety of different ways. It also recognises that performance pay can be an important part of any remuneration arrangement, and reflects the need to strike a balance between rewarding performance and avoiding inappropriate influence over financial advice. This is why the presumptions in section 963L are linked to the potential influence of the remuneration over the advice. If an employee is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to volume is presumed to be conflicted. However, if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned. This will depend on all of the circumstances at the time the benefit is given or received. Factors that will be relevant in assessing whether a benefit could reasonably be expected to influence the advice will include the weighting of the benefit in the total remuneration of the recipient, how direct the link is between the benefit and the value or number of financial products recommended or acquired and the environment in which the benefit is given. For example, if the benefit was based on the total profitability of the licensee, it was on a small percentage of the total remuneration of the recipient, and in order to qualify for the benefit, the recipient must also satisfy other criteria, such as criteria based on consumer satisfaction and compliance with internal processes and legal requirements, it would be less likely of being able to influence the recommendations or advice provided to retail clients[8].

Additionally, ASIC have issued regulatory guidance highlighting important principles and outlining a number of important concepts in relation to performance benefits paid subject to a balanced scorecard approach, being that not all performance benefits provided to employees could reasonably be expected to influence the advice they provide. We note that *Regulatory Guide 246: Conflicting remuneration* explains that not all performance benefits given to employees who provide financial product advice to retail clients are conflicted remuneration, and therefore, employers should consider a number of the factors in assessing whether they can demonstrate that a volume-based performance benefit is not conflicted remuneration[9]. However, legal uncertainty remains.

[7] The Revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 (Revised Explanatory Memorandum) covers measures to balance "influence". (Specifically, paragraph 2.20).
http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4739_ems_6e48ef62-f308-44a1-b58d-744f3992c8a1/upload_pdf/366354.pdf;fileType=application%2Fpdf

[8] Paragraph 2.20.

[9] *Regulatory Guidance 246: Conflicted Remuneration* [RG 246] (Specifically, Section D - RG 246.134-144).
http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg246-published-4-March-2013-B.pdf/$file/rg246-published-4-March-2013-B.pdf

Performance benefits may include bonuses, pay rises, promotion or other forms of recognition, reward-focused entertainment or travel, and shares or options in the employer's business. Performance bonuses, paid from a bonus pool arrangement, are derived from the offer of financial products by the bank, and therefore, relate to either or both value or number of financial products. Additionally, a performance benefit paid from a bonus pool arrangement might involve benefits relating to exempt and non-exempt products. Importantly, often it is difficult to quantify what part of the performance benefit paid from a bonus pool arrangement relates to a particular financial product.

The ABA believes that whether a performance benefit is conflicted needs to take into consideration the following aspects and factors:

1. The purpose of the performance benefit;
2. The weight of the benefit (e.g. component of remuneration related to non-exempt products is only a small proportion of the total remuneration – that is, the benefit is a low portion of the total remuneration for the period of which the performance benefit relates);
3. How direct the link is between the (otherwise conflicted) benefit and the value or number of financial products (e.g. the extent to which the benefit is linked to the performance of the wider business);
4. The proximity of the benefit to the advice (e.g. consideration of the individual's unique contribution to the bonus pool and whether the benefit is sufficiently remote from the advice); and
5. The environment and controls in place (i.e. a compliance system that ensures an individual's performance is measured against a balanced scorecard standard, which rewards compliant behaviour and gives weight to measures other than the provision of advice or sale of financial products).

The proposed amendment on performance bonuses based on volume is intended to ensure that benefits and payments can be made from a bonus pool arrangement where the revenue in the bonus pool is generated from distribution of, or advice on, exempt and non-exempt products where the benefit or payment is part of an employee's remuneration and the benefit is low in proportion and calculated according to a balanced weighting of matters.

The ABA does not believe that this proposed amendment would expand the FOFA provisions or allow conflicted remuneration to be paid, rather it clarifies the application and operation of the law with regards to performance benefits paid to employees (noting our comments above about agents, employees and representatives working under the name of the employer) without undermining consumer protection or the obligation on employers. The ban on conflicted remuneration will continue to provide protection against conflicted benefits and payments, as employers are prohibited from giving their employees and representatives conflicted remuneration (section 963J). We consider that this approach will provide legal certainty with the application and operation of the conflicted remuneration provisions as it applies to performance benefits paid to bank staff.

In the absence of this amendment, banks would be forced to alter their incentive schemes and enter into negotiations with employee representatives to change their enterprise agreements and other workplace agreements to the potential detriment of remuneration paid to bank staff.

Therefore, the ABA believes, for the avoidance of doubt, that an additional regulation should be made consistent with the important principles and concepts about the balanced scorecard approach already contained in the Explanatory Memorandum, which explains how parties can comply and ensure benefits and payments are not conflicted, having regard to a balanced scorecard approach, and ASIC's regulatory guidance.

However, the current wording does not adequately address the two limbs of the volume-based benefits presumed to be conflicted remuneration, being value and number (section 963L), and therefore, the proposed regulation should be amended. Additionally, the current wording does not explicitly relate the payment or benefit to the provision of personal advice that meets the best interest duty and subject to compliance controls which ensure processes around the determination of the payment or benefit satisfy the AFS licensees obligations specifically, and more broadly, in relation to these general obligations (section 912A).

The ABA supports the new Regulation 7.7A.12EB.

Regulation 7.7A.12EB(1) should be clarified so that a benefit must not be exempt under one of the exemptions listed in (i) to (v). This approach will ensure the intent is clearer, in that the regulation only applies to benefits that are not otherwise exempt.

Additionally, Regulation 7.7A.12EB(2) should be redrafted as follows:

Performance bonuses based on volume

(2) The requirements are that:

(a) the benefit is given to, or for, a provider who is an employee of an employer; and

(b) the benefit is an element of the employee's remuneration; and

(c) access to the benefit, or the value of the benefit, or both, is partly dependent on the total value or number of financial products of a particular class, or particular classes, that:

(i) the employee recommends to retail clients or a class of retail clients; or

(ii) are acquired by retail clients, or a class of retail clients, to whom the employee has provided financial product advice; and

(d) the benefit is low in proportion to the employee's total remuneration; and

(e) in calculating the benefit, the weighting attributed to the total value of financial products as described in paragraph (c) is outweighed or balanced by the weighting attributed to other matters; and

(f) if the benefit, or part of the benefit, relates to personal advice provided to a retail client, that the employer has in place compliance controls to ensure a retail client is given personal advice that is in the client's best interest. This approach would provide greater clarity to the intent of this sub-regulation. We note that the word "encourage" in the current drafting is problematic.

The ABA notes that sub-regulation 7.7A.12EB(1), for the avoidance of doubt, explicitly removes existing exempt products and circumstances from the requirements applicable to the bonus pool arrangement so that benefits and payments on exempt products and circumstances are not included in the considerations and calculations. This approach places the onus on the AFS licensee to ensure that in determining whether the benefit or payment is "low" that it relates to the portion that may be conflicted and the total remuneration of their employee for the period of which the performance benefit relates.

The ABA recommends that the Explanatory Statement should be amended to:

- Include that Regulation 7.7A.12EB does not prescribe this as the only way a bank or other employer can rebut the presumption of conflicted remuneration under section 963L, however, it provides a way for compliance to be demonstrated.
- Clarify that a performance benefit based only on non-volume-based criteria is not presumed to be conflicted remuneration (consistent with RG 246.137).
- Remove commentary to a benefit or payment being considered "low" if less than 10% of the total remuneration of the employee. This is inconsistent with the approach taken in RG 246, which identifies a number of relevant factors in this regard without prescribing a threshold (see RG 246, Table 3, pp38-39). For example, a higher threshold might be reasonable if the employee is not in close proximity of providing personal advice (noting that staff across banks and banking groups can gain access to a performance bonus, not just staff in advisory roles or frontline customer facing roles providing information and advice to consumers and retail clients).
- Add commentary around "compliance controls" and indicate that examples of these controls could include standard compliance controls and other procedures, such as specific training requirements, scripting and other adviser compliance tools, disciplinary action or claw back of benefits (if legal and compliance standards are not met), etc.

Conflicted remuneration – grandfathering for employees

The ABA was pleased that the grandfathering regulations were made in June 2013, and in particular, recognising the practical difficulties associated with certain employee remuneration arrangements. Since the FOFA provisions have been implemented and operationalised, and now coupled with these proposed amendments, there is legal uncertainty regarding certain arrangements in relation to employee remuneration.

Regulation 7.7A.16C sets an application date for benefits to employees of 1 July 2014, if the arrangement is not under an enterprise agreement, or where the benefits are given under an enterprise agreement, on a date related to expiry of the enterprise agreement. In practice, for a number of banks this means that new arrangements must be settled by 1 April 2014, due to the negotiation and performance cycle. We note that the extension from 1 July 2013 was critical for banks and banking groups given the need to reengineer and renegotiate enterprise agreements, and individual employment arrangements where terms were not contained within enterprise agreements. We also note that the new regulations will change a number of provisions relevant to employee remuneration.

The ABA believes that because the regulations will not be finalised until late March (at the earliest), and the final form of the legislation will not be known until it has passed through Parliament, this does not allow sufficient time for these banks to confidently implement FOFA-compliant solutions. Given this uncertainty, there is a need for a consequential amendment to Regulation 7.7A.16C to extend the dates set under Regulation 7.7A.16C by a further 12 months. Without this extension, banks and banking groups will need to design, negotiate and implement changes to current remunerations to be effective by 1 July 2014, but will then face the prospect of repeating the process once the changes are finalised.

The ABA supports extending the grandfathering for employee remuneration arrangements in Regulation 7.7A.16C to 1 July 2015. This approach will ensure that banks and other employers to renegotiate their remuneration arrangements with their employees once the law is confirmed, and therefore, not require parties to conduct a second round of negotiations and amendments. The extension should apply to employees covered by an enterprise agreement and also employees not covered by an enterprise agreement.

Additionally, the ABA recommends that a new regulation should be introduced to permit certain changes to arrangements without those changes impacting on the grandfathering of the arrangement, including:

- changes which do not affect the remuneration paid to agents, employees and representatives; or
- changes which do not have any material change to the remuneration paid to agents, employees and representatives; or
- changes where agents, employees and representatives have an entitlement to grandfathered benefits under an arrangement, so that the arrangement can be updated, amended or varied and the rights to the grandfathered revenue is not lost, as long as the entitlement to grandfathered revenue does not exceed 100% of the existing entitlement; or
- changes which are intended to reflect a change in a role (job description) of agents, employees and representatives; or
- any combination of the above changes.

This new regulation would address a number of practical difficulties associated with benefits for employees (noting that the concept of employee should apply similarly to agents, employees and representatives). It would enable changes to be made to an agreement (i.e. to accommodate the provisions and amendments to be FOFA-compliant) and/or changes to be made to individuals' workplace situation within the agreement (i.e. a change of role or job description) without the arrangement being deemed no longer grandfathered.

Best interests duty and conflicted remuneration – clarify application to retail investors

ABA position: The FOFA reforms should exempt sophisticated investors from the FOFA obligations. Therefore, the ABA supports this consequential amendment.

The ABA believes that, for the avoidance of doubt, the FOFA provisions should be clarified in relation to the application to retail investors, including that a sophisticated investor with an accountants' certificate is not deemed a retail investor for the purposes of the FOFA provisions. This approach would be consistent with the law more broadly as applied to sophisticated investors[10]. Therefore, the ABA supports the amendments in Schedule 1 with the correction to section 1368.

ASIC powers

The ABA notes that the FOFA provisions in the Corporations Act do not provide relief powers for ASIC. This is inconsistent with other sections of the law. This approach will ensure that appropriate transitional arrangements can be made and alleviate the need for ASIC to set out no action positions in regulatory guidance (which do not provide legal certainty).

The ABA recommends that general exemption and modification powers be included in the FOFA provisions both by regulation and ASIC relief consistent with other parts of Chapter 7 of the Corporations Act.

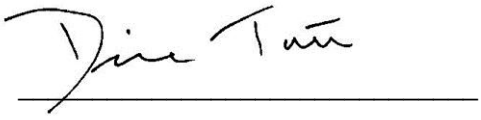
Concluding remarks

The ABA welcomes the FOFA Amendment Package as addressing concerns with the overreach of the FOFA provisions and the uncertainty associated with particular legislative and regulatory obligations. While there are some drafting corrections and consequential amendments required, the package of amendments ensures that the original policy intent of the FOFA reforms is maintained and improved standards will assist raise the quality of financial advice and build trust and confidence in the financial planning industry.

The ABA also welcomes the announcement by the Assistant Treasurer to review the professional standards of financial advisers, working cooperatively with the industry[11]. We strongly support this review and consider that it is a fundamental part of raising the quality of financial advice and building trust and confidence, not just in financial planning, but broadly across the banking and financial services industry.

The ABA believes that the FOFA reforms, as amended and targeted, will align the law to the original policy intent and ensure it works as intended. The amendments will also reduce unnecessary costs and red tape for financial advisers, including bank staff and make sure the industry is able to provide different products and services to consumers in different ways and in ways customers and clients expect. This will help drive improvements and innovations across the industry for the benefit of Australian consumers. Importantly, the FOFA provisions will continue to be a comprehensive suite of reforms promoting consumer protection and delivering higher standards of conduct and disclosure for financial advisers.

Yours sincerely,



Diane Tate

[10] Sophisticated investor test contained in section 761GA of the Corporations Act.
[11] http://axs.ministers.treasury.gov.au/speech/002-2014/