13 February 2014

General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: futureofadvice@treasury.gov.au

Dear General Manager,

Proposed Future of Financial Advice (FOFA) reforms

We welcome the government's proposal to cut the red tape created by FOFA. We broadly support the proposals, especially explicitly allowing for the provision of scaled advice and the removal of the opt-in requirements. However, we are concerned that the government has not looked to amend the provisions relating to the ban on charging asset based fees on borrowed amounts.

Where we see need for change

The prohibition on charging asset based fees on borrowed amounts is not in the public benefit. In the financial services sector the best model for investment management is lower brokerage rates combined with a low asset fee. As you know, much of the FOFA reforms stemmed from the likes of the Storm Financial collapse. The problem with Storm Financial wasn't the asset fee per se, but that the fees were up to seven percent coupled with double and triple gearing. Our clients simply do not invest in this manner.

People who borrow money usually require more advice, not less. It is a common mistake to think of borrowed money as needing higher returns and therefore one can take higher risk, when in fact the opposite is the case. Lower risk assets should be selected when using borrowed money to invest as one cannot afford to lose it, because the debt has to be repaid. In this case, well intended regulation is failing in its objectives.

An alternate to the ban on asset based fees on borrowed amounts, and much of the FOFA regulation, could be a simple rule that says if more than 10% of one's assets are going into any one investment, then a higher regulatory burden is required. It may be independent advice is required, or at the minimum, a standard warning included in the Corporations Law required to be provided to a prospective investor.

The cases in the media that capture the mind of the public are where someone invests all their money in one thing and that investment collapses and it reflects badly on the whole investment community. A 10% rule would greatly limit exposure to these kinds of investments. For example, it would stop accountants and other advisers putting large amounts of their clients' money, for potential tax benefits, in forestry schemes that fail. This rule would take the heat off politicians and reduce the regulatory burden on the vast bulk of normal investment decisions.

A note on warrants

At a minimum the government should consider the impact of the borrowed amount provisions on warrants. In RG 246.175 ASIC states the view that 'we consider that the ban on asset-based fees on borrowed amounts applies to the extent an asset-based fee is referrable to the debt component of an instalment warrant.' **We implore the government to reconsider this approach.** We submit that the FOFA reforms were not meant to impact warrants in this manner. Warrants are listed products and the debt component of the instalment warrant is inbuilt in the product, it is not discretionary.

The practical impact of ASIC's view is that instalment warrants have to be excluded from portfolio software that has an advice component to the fee, and charges an asset based fee. We are required to pay staff to manually exclude every warrant from portfolio software. The effect is that advisers will limit recommending warrants. The regulation has lead to less advice concerning warrants, not better improved advice. Warrants were not responsible for the collapse of the likes of Storm Financial that triggered many of the reforms. We submit the government, at a minimum, should consider a carve-out for warrants from the ban on charging asset based fees on borrowed amounts. However, even with this carve-out, the broader issues outlined above would not be solved.

The amendments we support

As mentioned we broadly support the proposed amendments. We believe the amendments will cut the red tape without prejudicing consumer protections.

<u>Removal of opt-in</u>

The removal of opt-in is a step in the right direction for the financial services industry. We strongly support the proposed removal. Opt-in was not practical. The cost and disruption to business from opt-in would have been astronomical. We do not accept arguments that the removal of opt-in is a loss to consumer protection. Consumers can opt-out at anytime. This is a practical and just solution.

<u>Removal of the "catch all" provision</u>

We support the removal of the "catch all" provision from the best interest duty. The catch all provision made the safe harbour unworkable due to lack of certainty. The catch all was not practical and would have resulted in increased litigation.

<u>Facilitating scaled advice</u>

A large proportion, if not all, of advice given in the stockbroking context is scaled advice. For example, clients regularly approach our firm with a sum of saved funds seeking advice on what stocks to invest in. The clients do not wish to disclose their financial information, or retirement plans etc; they simply want to know our stock recommendations given the amount of money to invest and their risk tolerance. We strongly support the proposed amendments to facilitate scaled advice.

<u>Changes to fee disclosure statements (FDS)</u>

Again, the proposed changes to the FDS provision are a practical solution. Although we do not consider giving a FDS as necessary, it was in no way practical to give these for pre-FOFA clients. The information for pre-FOFA clients was simply not available to comply with FDS requirements. We do not believe a FDS is necessary as clients regularly receive disclosure of fees, albeit they may be in a slightly different format to a FDS.

Exempting general advice form the ban on conflicted remuneration

We support exempting general advice from the ban on conflicted remuneration. This will allow many in the industry the chance to continue operating, which in turn will give consumers access to more avenues for advice.

Clarification of the client authorisation exemption

This is an important amendment. We thank the government for taking note of the lack of clarity on the client authorisation exemption. Without this exemption many of the products available to clients, including portfolio tracking software, would not be cost effective.

Changes to the stamping fee exemption

The proposed amendments to the stamping fee exemption will assist the industry in fundraising efforts. We support the proposed amendments. We submit that there is a need for the government to clarify the scope of the stamping fee exemption changes. There are conflicting views as to whether the exemption will apply to investment entities such as Real Estate Investment Trusts (REIT). Investment entities such as REITs should be able to benefit from the exemptions to allow for growth in their sectors.

Amendments to accountant certificates

We strongly support the governments proposed amendments to restore the expiry of accountant certificates for wholesale investors to two years. The exclusion of the provisions relating to account certificates from the original FOFA legislation was an obvious oversight. The two year expiry period is practical and been the accepted norm in the industry for years.

Timing issues

Much of the legal community has raised concerns about the timing around the commencement of the reforms. We echo support in the industry for many of the reforms being brought in through regulation. We support the view that the government should attempt to apply their reforms retrospectively and as quickly as possible, to avoid the potential for litigation from non-compliance with FOFA laws that are expected to be repealed.

Yours truly,

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