

May 2010 E-Bulletin

Financial advice and product distribution—beginning of the new era

Federal Government announces major reforms to regulation of financial advice

While much of the nation enjoyed the Anzac Day public holiday, the Federal Government was busy releasing its “Future of Financial Advice Information Pack”, which outlines significant reforms to the regulation of financial advice and investment product distribution in this country.

The reforms are a response to last year’s Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Finance Services (the Ripoll Inquiry), which was set up in the wake of the Storm Financial and Opes Prime collapses.

The government says the overarching aims of the reforms are to restore trust and confidence in the financial planning industry, through improving the quality of advice and strengthening investor protections; and to encourage more people to seek financial advice.

Key areas of reform

There are three key areas of reform:

- A ban on ‘conflicted’ remuneration structures, including commissions and any form of volume-based payments, relating to the distribution of financial products and provision of advice to retail investors (but not including risk insurance products, initially). The ban extends to the charging of fees based on a percentage of assets under management, where the fees are charged on geared investment amounts or products. This is to prevent the type of aggressive gearing strategies which became wide-spread before the onset of the Global Financial Crisis. However, interestingly, the ban will not yet apply to ‘soft dollar’ style benefits, which will be the subject of further investigation. Also, product providers such as fund managers will still be able to deduct an adviser’s agreed fee from the client’s application money (on behalf of the client).
- The introduction of a ‘product neutral adviser charging’ regime, which the government says will retain a range of flexible options under which consumers can pay for advice. The reforms include an ‘annual renewal’ system for continued (i.e., ongoing) advice services, under which retail clients must be

given a renewal notice each year and must positively 'opt-in' to the renewal of the adviser's services.

- The introduction of a statutory fiduciary duty for financial advisers, requiring advisers to act in the best interests of their clients. An interesting point here is that advisers may be forced to go beyond their 'approved product list' or recommend a client go elsewhere, when the adviser is unable to recommend a product from the adviser's own product list that is in the best interests of the client.

Other areas of reform

Other initiatives and reforms of note include the following:

- Removal of the Australian financial services licensing exemption for accountants who provide advice on the establishment and closing of self-managed superannuation funds.
- Improved and simplified disclosure regarding advisory services.
- Enhanced powers for the Australian Securities and Investments Commission (ASIC), in relation to the licensing and banning of individuals. The government says the intention is that ASIC will be able to more easily exclude undesirables from the financial services industry. In what may end-up a controversial move, it seems ASIC will be able to refuse or cancel a licence where it reasonably believes the licensee '*may not*' comply with their licence (i.e., even though there may not yet be any breach ASIC can point to).
- The definitions and therefore the classification of retail and wholesale clients will be reviewed.
- An expert advisory panel to review professional standards within the financial advice industry.
- Commissioning of an expert's report on a statutory financial services compensation scheme.

Timing and implementation of reforms

The ban on conflicted remuneration structures, the new adviser charging regime and the new statutory fiduciary duty will apply from 1 July 2012; although the dates for the release of draft legislation, and the consultation period or periods, have yet to be announced by the Government.

The reforms will have a huge impact on the manner in which investments are distributed and advice is provided (although the industry of course knew that the end of commission-based payment structures was in sight). The devil is in the detail as always; and McMahan Clarke will continue to monitor and keep you

informed of further developments. For more information, email **Shawn Chan** or **Matthew Moses**; or call 07 3239 2906.