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*Practice Group(s):*

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## Proposed FoFA Reforms to Ease Regulatory Burden

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In line with their pre-election commitments, on Friday 20 December, the Australian Government announced plans to reform the Future of Financial Advice (FoFA) legislation. Many of the changes go beyond what had previously been announced and will significantly ease the regulatory burden for financial advice providers.

While the Government has stated that it "supports the principles of FoFA", the proposed reforms are intended to reduce the regulatory burden on financial service providers and clarify the application of the more controversial aspects of the FoFA regime.

### Key Changes

The proposed amendments will introduce a number of substantive changes to the FoFA regime, which are discussed below.

#### *Removal of the two year opt-in*

The two-year opt-in required financial advisers to obtain a client's consent to continue providing financial advice every two years. The removal of the opt-in is largely supported by the industry and was a key reform noted in the Government's election platform.

#### *Removal of the 'catch all' provision in the 'safe harbour' defence*

The FoFA legislation introduced a duty for all advisers to act in the best interests of their clients. The 'safe harbour' defence allows advisers to demonstrate that they have met this duty by taking certain prescribed steps.

These steps currently include a 'catch all' provision which requires that financial advisers take all steps which "would reasonably be regarded as being in the best interests of the client" in order to meet their best interests duty.

This requirement was considered to be overly broad and unclear for advisers. The Government has indicated that the removal is necessary to "ensure advisers can be confident they have provided compliant advice".

#### *Removal of the requirement to disclose annual fees to existing customers*

The current requirements for annual fee disclosures apply to all clients of financial advisers who provide advice under an ongoing fee arrangement. This has been subject to some controversy as it requires advisers to provide disclosures to clients who entered into agreements before the commencement of the FoFA reforms on 1 July 2013.

The Government intends to remove this retrospective application, so that advisers will only need to provide annual fee disclosures to clients who entered into an ongoing fee arrangement on or after 1 July 2013.

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### *Exempting general advice from conflicted remuneration*

A key aspect of the FoFA legislation was the introduction of a prohibition on commissions and other payments of benefits to advisers which could reasonably be expected to influence advice. Such benefits are known as 'conflicted remuneration'. This conflicted remuneration ban currently applies to both general and personal advice. The Government now intends to limit the ban to personal advice only.

This amendment recognises there is less scope for a benefit to influence an adviser who is giving general advice and that general advice is given in a wide variety of circumstances and is often used to inform clients of their overall options. As such, compliance with conflicted remuneration for general advice was likely to be costly and create a large administrative burden.

This reform will significantly alter the application of the conflicted remuneration provisions and is likely to be welcomed by the industry.

### *Amendments to grandfathering provisions*

Currently, grandfathering is available for a range of pre-existing arrangements which were in place before the conflicted remuneration ban was implemented. These grandfathering provisions enable advisers to continue to receive benefits which would now be considered conflicted. There is considerable doubt in the industry as to whether grandfathering survives various changes, such as an adviser changing licensee or selling their business.

The Government proposes to make it clear that events like this will not impact grandfathering. This is expected to remove a potential barrier to flexibility and competition in the industry.

### *Payment of 'balanced' benefits*

A proposed amendment which has not previously been discussed by the Government is to introduce a carve-out of the conflicted remuneration provisions to allow for the payment of benefits under a 'balanced remuneration structure'.

The Australian Securities and Investments Commission (ASIC) guidance on FoFA compliance has indicated that employees can receive salaries and bonuses under a 'balanced score card' without offending the conflicted remuneration ban. This balanced score card enables benefits to be paid to employees to reward good performance, provided the benefits are aligned with the best interests of the client. Such benefits are measured against criteria including customer satisfaction, and compliance with quality and training standards.

The Government's proposal in this regard is quite brief, but it appears it intends to expand the availability of this approach, possibly to authorised representatives as well as employees.

## Clarifications

In addition, the proposed amendments include clarifications to:

- explicitly permit the provision of scaled advice under best interest duty and simplify the processes for advisers and clients to agree to limit the subject matter of advice
- expand the training exemption to the conflicted remuneration ban

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- further limit the ban on conflicted remuneration in respect of life insurance within superannuation. Under the proposals, commissions would only be banned in respect of default insurance arrangements where no personal advice has been given in relation to the insurance
- broaden the application of the execution only exemption to the conflicted remuneration ban
- expand the definition of the basic banking exemption to include additional simple banking products, such as basic deposit, non-cash payment and first home saver account products.

### Conclusion

The proposed changes have the potential to significantly reduce financial advisers' obligations under FoFA. However, the Government's ability to pass the necessary legislation is yet to be tested, and with both Labor and the Greens indicating an intention to block the reforms in the Senate, changes are unlikely to be implemented before July 2014.

In light of this, ASIC has taken a 'no action' position in relation to the specific FoFA provisions which have been flagged for repeal, although they will continue to monitor and provide advice on compliance with FoFA requirements.

The industry will need to continue monitoring these developments and pay close attention to both ASIC and Government positions to ensure compliance with the FoFA regime.

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