FSC SUPPLEMENTARY

CORPORATIONS AMENDMENT

(Streamlining of Future of Financial Advice) BILL 2014

MAY 2014

APPENDIX 3: Research supporting the FSC Submission

The following research has been referenced in the FSC submission to the Senate Economics Legislation Committee for inquiry and report into the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 .

Financial Services Council

A comparison of financial advice regulations - personal advice for retail clients

5 May 2014

Deloitte.

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Mr Andrew Bragg
Director of Policy and Global Markets
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5 May 2014

Dear Andrew

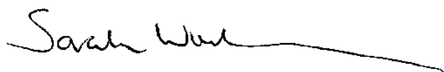
Re: A comparison of financial advice regulations

The Financial Services Council ("FSC") has requested Deloitte to compare the regulatory framework governing personal financial advice for retail clients in Australia with that in other developed jurisdictions to inform the FSC's submission to a Senate inquiry on the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014. The comparison was conducted on the basis of information available as at April 2014.

We have discussed the matters in this Report with you and, where appropriate, the results of these discussions have been included in this Report.

Please do not hesitate to contact me or Andy Abeya should you have any questions or comments in relation to the matters raised in this Report.

Yours sincerely



SC Woodhouse
Partner

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Member of Deloitte Touche Tohmatsu

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1 Executive Summary

On 20 March 2014, the Senate referred the Corporations Amendment (Streamlining of Future of Financial Advice) ("FOFA") Bill 2014 to the Senate Economics Legislation Committee for inquiry and report (the Inquiry). To inform the Financial Services Council's ('FSC") submission to the Inquiry, the FSC has requested that Deloitte perform research on the regulatory landscape affecting retail personal financial advice in Australia, focusing on those aspects that come within the scope of the Inquiry, and compare these to the developed jurisdictions of the United Kingdom ("UK"), United States of America ("USA"), Canada, Singapore and Hong Kong.

The research addresses the following specific areas:

- Licences required to provide financial advice
- Statutory duties imposed on the providers of financial advice
- Disclosure requirements for those providing financial advice
- Prohibitions on conflicted remuneration
- Any other requirements to manage the conflicts of interest for providers of financial advice

For the purposes of the research and comparison, the proposed changes to FOFA in the above named Bill relate to those currently in place in Australia. Where reforms in other countries have been proposed but have not yet been introduced, these have not been considered. Where they have been enacted but not yet due, these have been considered (Canada specifically).

We acknowledge that this Report may be used by the FSC as part of its submission to the Inquiry.

It is important to note that the comparisons provided in this Report:

a) consider the requirements for personal advice provided to retail clients and therefore exclude general advice and advice provided to wholesale clients;
b) were performed based on a factual analysis of the current state of each jurisdiction, and do not consider impending changes to legislation and regulations (outside of Australia), case law interpretations, and/or general industry trends for each jurisdiction; and
c) provide results that are indicative only based on high level comparisons and do not necessarily reflect the same accuracy as would be true of a comprehensive benchmarking study.

The comparisons show that overall Australia has a higher standard of regulation with more prescriptive requirements than the other countries studied. The regulatory framework in the UK appears to be the most comparable to Australia, and the USA the least comparable. In respect of the five specific areas considered:

- The licensing requirements at both an organisational level and individual adviser level are comparable to Australia across jurisdictions in scope, except for the USA where the requirements are less prescriptive.
- While each regime imposes statutory duties on the providers of financial advice, only the UK has a duty which is of a comparably high standard to that required in Australia.
- In all jurisdictions advisers must (or under a code of conduct), prior to the provision of financial advice, disclose to clients information that is somewhat comparable to the information disclosed in an Australian Financial Services Guide.
- Australia and the UK are the only jurisdictions that require specific disclosures including client objectives and advice recommendations to be documented for the client at the time of providing financial advice. The UK's 'suitability letter' requires less fulsome disclosure than a Statement of Advice ("SOA"), and is only required for certain packaged products.
- Australia and the UK are the only jurisdictions considered in this study to prohibit conflicted remuneration in certain circumstances.
- All jurisdictions have conflict of interest requirements to some degree.

2 Background

In 2009 the provision of financial advice came under the spotlight. Following the collapse of financial product and service providers – in particular Storm Financial and Opes Prime – the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into issues associated with the provision of financial advice in Australia.

The Committee's Inquiry into financial products and services in Australia concluded that there were areas where regulatory intervention could help to avoid similar collapses in the future, and support better outcomes for investors and consumers. It suggested the following broad areas of reform:

- raising standards of advice;
- making disclosure more effective;
- outlawing conflicted remuneration practices; and
- ensuring better transparency, competency and accountability through the licensing system.

The Federal Government announced the 'Future of Financial Advice' reform package in 2010 in response to the recommendations of the Inquiry. The package aimed to

> *"address the conflicts of interest that have coloured the perception – and sometimes the reality – of the quality of financial advice provided to Australian investors. … financial advice… must abide by a fundamental ethical principle. That principle is that the financial advice given to Australian investors should be in their best interests."*

The FOFA reforms passed into law in 2012 and took effect on 1 July 2012 with compliance mandatory from 1 July 2013. The key areas of regulatory change as described in the package included:[1]

- banning 'conflicted remuneration' structures, such as commissions;
- introducing a statutory fiduciary duty for advisers to act in the best interests of their clients;
- moving towards 'fee for service' arrangements for charging; and
- insisting that financial advisers operate on the basis of clients 'opting in' rather than operating continuously until they opt out.

Various aspects of the FOFA reforms continue to be subject to legislative change. The Corporations Amendment (Streamlining Future of Financial Advice) Bill 2014 was introduced on 19 March 2014 to implement the Government's announced package of changes to FOFA, and proposes to:

- remove the opt-in requirements;
- remove the annual fee disclosure requirements for pre-1 July 2013 clients;
- remove the 'catch-all' provision from the best interests duty;
- explicitly allow for the provision of scaled advice;
- exempt general advice from the ban on conflicted remuneration; and
- broaden the existing grandfathering provisions for the ban on conflicted remuneration.

[1] Source: Minister for Financial Services, Superannuation and Corporate Law, 2010

Controlling, managing and investing money is an important aspect of day-to-day life. People's competence in managing their personal finances can have significant effects on their wealth and wellbeing, both in the short and long term.

However, managing one's financial affairs successfully can be difficult. Markets are volatile and unpredictable. There is a profusion of products available, with technical specifications and characteristics that can be difficult to understand. Hence the provision of quality advice at an affordable price is vital to the wellbeing of Australians.

Human behaviour can further complicate effective decision-making. Behavioural economics shows that clients do not always act in a rational manner. Some of the factors which contribute to irrational choices include:

- **myopia (short-sightedness)** means that clients often prefer (and choose) short-term spending or gains over long-term investments, even when the long-term investment will create more value over time;
- low levels of **financial literacy** mean that a client's financial decisions are sometimes based on a poor understanding – or even a wrong one—for example, in a 2011 study, fewer than half of all Australians surveyed correctly answered six financial numeracy questions, while 40% of respondents did not understand compound interest; and
- even when clients know how they should react analytically to rational problems, they often **respond emotionally**, as is evident in the stock market where equity values can quickly plummet when people panic. (Harry Markowitz – a Nobel Prize winning economist who studied portfolio selection – famously failed to apply his own theory when choosing how to invest his retirement savings.)

Given the range of challenges associated with investing and managing finances, clients often seek external advice.

Financial advisers can help to mitigate many of the difficulties listed above. As professionals, they have greater expertise in understanding the products and services available, and in analysing the relative risks and benefits of each. They have the time to monitor investments and markets. Advisers are less influenced by behavioural issues, since they are further removed from the impacts.

While financial advisers exist to educate and advise their clients, they may nevertheless act in their own best interests rather than those of their clients. This could involve:

- recommending or directly investing clients funds in products which may not be appropriate for the client but which generate financial commissions for the financial adviser;
- providing 'default' advice not based on the specific needs and circumstances of the client because this is less time-consuming; and
- failing to disclose or deliberately 'burying' negative information because it may induce a client to choose another financial adviser.

Increasing transparency in financial advice and more closely aligning incentives to high quality financial advice are attempts to address these matters through a regulatory solution.

Many countries have implemented regulatory schemes intended to address the same issues. Ultimately, the success of any scheme should be assessed by its ability to ensure that clients receive high quality financial advice that is in their best interests.

This report considers how Australia's reforms[2] compare with those of other countries in addressing the following issues:

- **What are the licensing requirements required to provide financial advice?** – this affects the quality of advice provided.
- **What are the statutory duties imposed on the providers of financial advice?** – this affects the incentives facing advisers.
- **What are the disclosure requirements when providing financial advice?** – this affects the ability of investors to monitor and assess the performance of advisers, and understand the true cost of advice.
- **What, if any, are the conflicted remuneration prohibitions?** – this affects the incentives facing advisers.
- **What are other requirements, if any, to manage conflicts of interest facing providers of financial advice?** – this affects whether advice provided is in the client's best interests.

[2] For the purposes of the research conducted, the proposed changes to the FOFA Bill have been included in the comparison.

3 Comparison Summary

In relation to licensing, adviser statutory duties, disclosures, conflicted remuneration, and conflicts of interest, the research in Section 4 sets out the regulatory framework by country.

The research then compares each country's framework to Australia. The results of this comparison are summarised in Table A below.

For the purposes of the research and comparison conducted, the proposed changes to FOFA in the 2014 Bill have been assumed to be in place for the Australian position. Where reforms in other countries have been proposed but have not yet been introduced, these have not been considered in their position. Where they have been enacted but not yet due, these have been considered (Canada specifically).

It is important to note that the comparisons:

a) consider the requirements for personal advice provided to retail clients and therefore exclude general advice and advice provided to wholesale clients;
b) were performed based on a factual analysis of the current state of each jurisdiction, and do not consider impending changes to legislation and regulations (outside of Australia), case law interpretations, and/or general industry trends for each jurisdiction; and
c) provide results that are indicative only based on high level comparisons and do not necessarily reflect the same accuracy as would be true of a comprehensive benchmarking study.

Key for Table A:

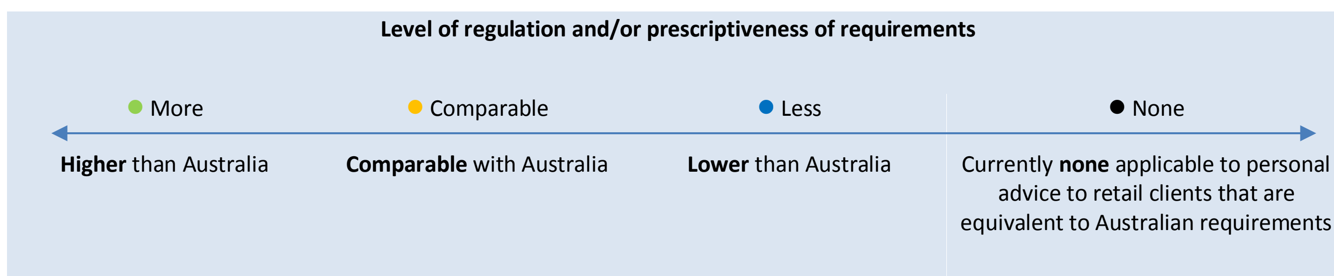

Table A: Summary – Country comparison of financial advice regulations

Australian requirement	Indicative comparisons				
	Canada	Hong Kong	Singapore	UK	USA
Licensing requirements					
Organisation requirements – Must hold Australian Financial Services Licence and meet obligations on governance, organisational competence, risk management, financial capital, technology, human resources, insurance and disclosure.	● Comparable	● Comparable	● Comparable	● Comparable	● Less
Individual adviser requirements – Must hold Diploma Financial Services qualification, relevant accreditations and maintain annual Continuing Professional Development.	● Comparable	● Comparable	● Comparable	● Comparable	● Less
Statutory duties					
Client centricity – Must demonstrate client's best interest and demonstrate compliance with safe harbour steps.	● Less	● Less	● Less	● Comparable	● Less
Disclosure requirements					
Must provide Financial Services Guide to client prior to giving advice.	● Comparable	● Less	● Comparable	● Comparable	● Comparable
Must document client objectives, financial circumstances, recommendations, alternatives considered, risks, fee and conflict disclosures (usually in a Statement of Advice).	● None	● None	● None	● Less	● None
Must provide Fee Disclosure Statement on annual basis where ongoing services are provided to review clients.	● None	● Less	● None	● Less	● None
Conflicted remuneration prohibitions					
Ban on remuneration and benefits that could reasonably be expected to influence the financial product advice given.	● None	● None	● None	● Comparable	● None
Conflict of interest requirements					
Further to the statutory duty to prioritise client interests, required to manage conflicts of interest through either controlling and avoiding or disclosing.	● Comparable	● Less	● Comparable	● Comparable	● Comparable

4 Country Comparison

5.1 Australia

Note: For the purposes of this summary, the changes proposed under the Corporation Amendment (Streamlining of Future of Financial Advice) Bill 2014 are assumed to be in place.

Licensing requirements for financial advice providers

An organisation must obtain an Australian Financial Services Licence ("AFSL") before its representatives or authorised representatives can provide financial advice, unless it is covered by an exemption or it is authorised to provide financial advice as a representative of another organisation that holds an AFSL. To obtain an AFSL, an application must be lodged with ASIC, and the organisation must show that it can meet standards in relation to:

- organisational competency (under ASIC Regulatory Guide ("RG") 105);
- risk management and compliance arrangements (under ASIC RG 104);
- financial, technological and human resources (under ASIC RG 166 and RG 104);
- conflicts of interest (under ASIC RG 181);
- adviser conduct and disclosures (under ASIC RG 175 and RG 182);
- training (under ASIC RG 146);
- professional indemnity insurance (under ASIC RG 126); and
- dispute resolution arrangements (under ASIC RG 165).

To become a qualified financial adviser, individuals are required to attain the Diploma Financial Services (Financial Planning) qualification. Accreditations are also required for specialist areas such as self-managed superannuation funds, gearing and derivatives. Advisers are also required to meet a minimum of 90 Continuing Professional Development hours on a triennial basis.

Statutory duties imposed on advice providers

Providers of personal financial advice must:

- act in the best interests of the client demonstrated through completion of the safe harbour steps;
- provide the client with appropriate advice;
- warn the client if the advice is based on incomplete or inaccurate information; and
- where there is a conflict with their own interests, or those of one of their related parties, prioritise the interests of the client.

Disclosure requirements

A Financial Services Guide ("FSG") must be given to retail clients before providing financial services to them. An FSG must include information such as the kinds of financial services that the organisation is authorised or likely to provide, and how the providing entity and its associates will be paid for the advice.

Financial advice providers must generally give their clients a SOA where personal advice is being provided. An SOA must set out, in a clear, concise and effective manner:

- the advice and the reasoning that led to the advice;
- information about remuneration and benefits;
- all conflicts of interest that may affect the advice; and
- the costs, loss of benefits and other significant consequences when recommending switching between financial products.

Financial advice providers are also obligated to give a Fee Disclosure Statement (“FDS”) if an ‘ongoing fee arrangement’ exists. An ongoing fee arrangement exists where a client receives personal advice, and the client enters into an arrangement with the financial advice provider after 1 July 2013, the terms of which provide for the payment of a fee during a period of more than 12 months.

Conflicted remuneration prohibitions

The conflicted remuneration provisions ban many benefits (including commissions, volume-based payments, soft dollar benefits, and volume-based shelf space fees) given to those persons who provide financial product advice to retail clients that could reasonably be expected to influence the financial product advice they give. A specific ban also applies to the charging of asset based fees by advisers on geared amounts.

The ban does not apply to some products and advice services, including for example:

- general insurance, where the benefit only relates to a general insurance product;
- basic banking products where advice is only given on a basic banking product;
- general financial product advice; and
- financial product advice given to wholesale clients.

Conflict of interest requirements

Further to the statutory duty for advisers to prioritise the client’s interests ahead of their own interests or those of related parties, licensees are also required under ASIC RG181 to manage their conflicts of interest through either controlling and avoiding or disclosing.

Other requirements that deal with conduct in relation to conflicts of interest management include:

- the obligation to do all things necessary to ensure that their financial services are provided efficiently, honestly and fairly;
- the obligation to have adequate risk management systems;
- the obligation to comply with financial services laws and to take reasonable steps to ensure their representatives do likewise; and
- the obligation to have adequate compliance arrangements.

5.2 Canada

Note: For the purposes of this summary, the amendments to the National Instrument 31-103 (NI 31-103) are assumed to be in place.

Licensing requirements for financial advice providers
Firms have to register with applicable provincial securities commission under NI 31-103 in the appropriate category prior to provision of any advice or distribution of products. For example, firms seeking registration in Ontario will need to register with Ontario Securities Commission. The firms and the individuals registered with the securities commissions are subject to individual securities act, e.g. Ontario Securities Commission administers the Securities Act and Commodity Futures Act.

In Quebec, the firms are regulated by the Autorité des marchés financiers ("AMF"). Business activities trigger various registration categories, e.g. portfolio manager, dealer, investment fund manager. In addition, firms that are members of the self-regulatory organisations ("SROs"), such as IIROC (securities distribution) or MFDA (investment funds distribution) are subject to the rules of the SROs. There are governance, regulatory capital, insurance, compliance policies and procedures, business continuity plan, books of records, conflicts of interest and other requirements that need to be met prior to registration and once approved.

In addition to the firms' registration requirements, individuals are subject to the registration and licensing requirements. Proficiency requirements apply to individuals prior to being approved in specific categories (as per NI 31-103) and IIROC/MFDA rules.

Statutory duties imposed on advice providers
Financial advisers do not have a fiduciary duty to their clients. Instead of looking after the best interests of the investors they serve, advisers currently need only meet a 'suitability standard,' providing advice or selling products that conform with the investor's financial circumstances, investment objectives, risk tolerance, time horizon etc.

As per the provincial securities acts, financial advisers have a duty of care to act fairly, honestly and in good faith. This includes, amongst other things, knowing the client's financial circumstances, objectives and risk tolerance. It also requires that advisers understand the products they offer so they can recommend suitable products to each client. In addition to the provincial securities commissions' acts and regulations, there are a number of guidelines issued by IIROC that need to be met.

Disclosure requirements
The Client Relationship Model ("CRM") brought amendments to the NI 31-103, requiring enhanced disclosure and reporting requirements. There are key compliance dates (July 2014, 2015 and 2016). The CRM makes it mandatory for financial advisers to fully disclose all transaction details, commission and fee breakdowns as well as annualised rates of return for client portfolios. Currently, applicable requirements mandate that advisers regularly evaluate whether their clients' investing strategy and risk tolerance matches their goals and time horizon with additional check-ins at certain 'trigger' events like steep, prolonged market drops (i.e. ongoing suitability requirements).

In addition, mutual fund companies are required to prepare and file a Fund Facts (a plain language, two page summary of key information about mutual funds, which provides a basic description of a class or series of a specific fund, an explanation of expenses and fees, and the investor's rights) for each class or series of each of their mutual funds and to post the Fund Facts to their website. Effective June 13, 2014, mutual fund companies are required to deliver the Fund Facts within two days of buying a conventional mutual fund. The prospectus for a mutual fund will continue to be available to investors upon request.

Conflicted remuneration prohibitions

Most financial advisers receive a commission payment for the financial products that they offer to clients. In addition, advisers may receive trailers and other forms of compensation. As per the new requirements put forward by CRM, trailers and other embedded commissions will need to be fully disclosed.

Conflict of interest requirements

Under NI 31-103, financial advice providers are required to take reasonable steps to identify any existing or potential material conflicts of interests and to respond to such conflicts of interest by avoiding, controlling or disclosing them. Financial advice providers are expected to have developed procedures to deal with conflicts of interest on this basis, including with respect to related and connected issuers. Disclosure to clients must also be done on a timely basis and will have to adequately disclose the nature and extent of the conflict of interest (i.e. generic disclosure will not suffice).

5.3 Hong Kong

Licensing requirements for financial advice providers

There are 10 types of regulated activities in the financial service industry supervised by the Securities and Futures Commission ("SFC"). All entities, including authorised financial institution under section 2(1) of the Banking Ordinance, are required to obtain SFC licenses prior to carrying out any regulated activities. In relation to providing financial advice, SFC licences for Type 4 (Advising on securities), Type 5 (Advising on futures contracts) or Type 6 (Advising on corporate finance) are required. Authorised institutions are expected to notify their primary regulator, Hong Kong Monetary Authority ("HKMA"), prior to submitting an application for registration to the SFC.

Applications to the SFC will include:

- Organisational charts with key human resources and their reporting lines.
- Operational flowcharts describing principal business operations.
- Inherent risks to principal regulated business activities (such as market risk, credit risk, liquidity and operational risk) and risk control strategy.
- Potential areas of conflict of interests, and measures to address the conflict.
- Procedures to achieve segregation of duties.
- Contingency plan.

Provided the relevant application forms and details as noted above are provided to SFC, no major challenges are expected with the application.

Statutory duties imposed on advice providers

In Hong Kong, there are similar regulatory requirements imposed on the providers of financial advice, which are specified in the 'Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission' ("COC") such as:

- Honesty and Fairness Principle – In conducting its business activities, the regulated entity should act honestly, fairly, and in the best interests of its clients and the integrity of the market.
- Diligence Principle – In conducting its business activities, the regulated entity should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

Disclosure requirements

In Hong Kong, pre-sales disclosure requirements are imposed on the providers of financial advice, which are specified in the COC such as:

- Monetary benefits for explicit or non-explicit remuneration arrangement and trading profit made from a back-to-back transaction;
- Non-monetary benefits;
- Transaction related information including the capacity (principal or agent) in which the regulated entity is acting; and
- Terms and conditions in generic terms under which client may receive a discount of fees and charges from a licensed or registered person

During the account opening stage, the regulated entity is required to provide the risk disclosure statements, and both a declaration by the client staff and acknowledgement by the client are required before the initial services are provided to the client.

Conflicted remuneration prohibitions

There are no explicit rules and regulation in Hong Kong on this topic. However, HKMA expects financial institutions to have incentive systems that avoid rewarding staff on the basis of sales volume and commission earned, which would nurture a tendency to push financial products to customers to meet business targets without giving sufficient regard to the interests of the customers.

The HKMA also reminds providers of financial advice to be mindful of the possible incentives for benchmark manipulation in formulating remuneration policies and take active steps to reduce such incentives.

Conflict of interest requirements

Conflicts of interest are mainly managed via disclosures. According to the COC issued by the SFC, where the regulated entity has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

5.4 Singapore

Licensing requirements for financial advice providers

Financial advisers are licensed and regulated under the Financial Advisers Act (Cap 110) ("FAA"). The types of financial advisory services regulated under FAA are as follows:

- Advising others concerning any investment product, other than advising on corporate finance;
- Issuing or promulgating analyses or reports concerning any investment product;
- Marketing of any collective investment schemes including unit trusts; and
- Arranging life insurance products.

Corporations which carry on a business of providing any financial advisory service are required to hold a financial adviser's license under the FAA unless they are exempt under section 23 of the Act. Individuals who are employed by or acting for a corporation which is licensed or exempt under sections 23 (1)(a) to (e) of the FAA to provide any financial advisory service are required to be an appointed or provisional representative under the FAA.

Corporations that are exempt from holding a financial adviser's licence are banks, merchant banks, finance companies, insurance companies, insurance brokers registered under the Insurance Act, holders of a capital markets services licence under the Securities and Futures Act (Cap 289) ("SFA"). They are exempt from holding a financial adviser's licence to act as a financial adviser in Singapore in respect of any financial advisory services. Nonetheless, exempt financial advisers and their appointed and provisional representatives are required to comply with the business conduct requirements stipulated in the FAA.

Applicants for a financial adviser's licence are required to satisfy certain criteria, including but not limited to the following:

- have adequate financial resources to perform the proposed activities;
- have the relevant competence and expertise (including adviser fit and proper exams and attestations); and
- have satisfied the Monetary Authority of Singapore ("MAS") that they would discharge their duties efficiently, honestly and fairly.

Statutory duties imposed on advice providers

There are obligations imposed on both the financial advisers as well as their representatives as set out in the FAA and majority focused on the Conduct of Business, under Part III of the Act. They are grouped under General, specifically to Life Insurance, Securities and to Appointed and Provisional Representatives. With respect to General, the FAA covers the obligations to disclose all material information relating to the investment product to clients, that product recommendations must have a reasonable basis, obligations to furnish information to Authority and requirements pertaining to the receipt of client's money/property.

The above are supplemented with Financial Advisers Regulations ("FAR") as well as relevant Notices which spell out in greater detail the requirements that financial advisers and their representatives have to adhere to.

Disclosure requirements

Pursuant to section 25 of FAA, it imposes an obligation on licensed financial advisers to disclose to their clients and prospective clients all material information relating to any designated investment product recommended by the licensed financial advisers, including the form and manner in which the information all be disclosed. Section 26 of FAA provides that no licensed financial adviser shall, with intent to deceive, make a false or misleading statement as to any amount that would be payable in respect of a proposed contract relating to any investment product or the effect of any provision of a contract or proposed contract relating to the investment product.

FAA-N03: Notice on information to clients and product information disclosure, sets out in greater details the general principles that apply to all disclosures by a financial adviser to its clients. It also sets out specific requirements as to the form and manner of disclosure that financial advisers have to comply with in relation to sections 25 and 26 of FAA as well as the following matters:

- Setting out the general disclosure principles is to provide clear, adequate and not false or misleading information to clients.
- Financial advisers to disclose their general information (business name, address, telephone numbers), types of financial advisory service/investment products that it is authorised to provide.
- Financial advisers to disclose to client all remuneration including, commission, fees and other benefits that it has received or will receive.
- Financial advisers to disclose to client any actual or potential conflict of interest arising from any connection to or association with any product provider.
- Financial advisers to disclose various details with regards to the designated investment products which it recommended.
- Financial advisers to provide illustration of past and future performance of designated investment product.

Conflicted remuneration prohibitions

There is no explicit remuneration prohibition. However, all remuneration, including fees, commissions and other benefits such as trailer fees, soft dollars, sales bonuses that a financial adviser receives or will receive has to be disclosed to the client as well as any actual or potential conflict of interest issues. The relevant requirements are covered under the same regulations and notice as cited in the section preceding this one.

In addition, per FAA-G11: Guidelines on fair dealing, MAS commented that remuneration structures that rely primarily on commissions or are biased towards regarding representatives for recommending certain investment products may encourage poor market conduct practices such as product pushing and improper switching, e.g. are product quotas and highly differentiated commissions for the sale of different products. Financial institutions are asked to ensure that their remuneration structures encourage representatives to act in the best interests of customers in the course of providing financial advisory services.

Conflict of interest arrangements

Generally, the obligation to manage conflicts of interest is applicable to the provision of every type of financial advisory service under the FAA. Regulation 14(b)(viii) of the FAR (Rg2) stipulates that a corporation that has a financial adviser's licence shall, in the manner that is commensurate with the nature, scale and complexity of its business, ensure effective controls and segregation of duties to mitigate potential conflicts of interest that may arise from tis operations.

FAA-N03: Notice on information to clients and product information disclosure, sets out the general principles that apply to all disclosure by a financial adviser to its clients. On conflicts of interest, it requires a financial adviser to disclose, in writing, to its clients any actual or potential conflict of interest arising from any connection to or association with any product provider, including any material information or facts that may compromise its objectivity or independence in its provision of financial advisory services.

FAA-G13: Guidelines on addressing conflicts of interest arising from issuing or promulgating research analyses or research reports, focus specifically on the conflicts of interest that may arise from issuing or promulgating research analyses or research reports, and the standards and practices expected of the licenced corporation and its representatives in addressing such potential conflicts of interest arising from the financial advisory services.

5.5 United Kingdom

Licensing requirements for financial advice providers

Firms who wish to be directly authorised to carry out business in the UK must apply for a Part IV permission from the Financial Conduct Authority ("FCA") prior to carrying out any regulated activities (including financial advice). The FCA assesses the firm against the "Threshold Conditions" and the individuals running the firm for "Fitness and Propriety."

In order to provide financial advice, a firm must have some or all of the following permissions (depending on the nature of the advice to be provided):

- Advising on investments (except on Pension Transfers and Pension Opt Outs); Advising on Pension Transfers and Pension Opt Outs; Arranging (bringing about) deals in investments; Making arrangements with a view to transactions in investments

The Systems and Controls ("SYSC") requirements in the FCA handbook places requirements on:

- Senior Management arrangements; Systems and controls; Compliance, Internal Audit and Financial Crime; Risk Control; Outsourcing; Record-keeping; Conflicts of Interest

Individuals who offer financial advice must be an FCA approved person – Controlled Function CF30 – Customer Function. Individual Financial Advisers ("CF30") must be qualified to a minimum standard (Qualifications and Credit Framework - Level 4) and must complete a minimum of 35 hours Continual Professional Development hours per year (including a minimum of 21 hours structured learning). They must hold a Statement of Professional Standing ("SPS") by a recognised professional body.

Some firms (deposit takers, insurance firms) may be dual-regulated by both the Prudential Regulation Authority ("PRA") and the FCA. A dual-regulated firm must make a single application to the PRA. In these circumstances, the PRA would be the lead regulator and will regulate the firm for prudential requirements. The FCA will regulate how the firm conducts their business.

Statutory duties imposed on advice providers

In the UK, the Principles for Business set out the requirements for authorised firms. Several of the Principles refer specifically to how firms should treat their customers. The Conduct of Business Sourcebook ("COBS") provides further detail: COBS 2.1.1 states: A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule). COBS 9 – Suitability sets out the detailed rules governing financial advice. COBS 9.2.1 states "A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client."

The Retail Distribution Review ("RDR") imposed additional requirements from 31 December 2012 on firms providing financial advice. Firms are required to disclose the nature of their service (i.e. independent or restricted advice). On a quarterly basis, Financial Advice firms are required to report on the names and FCA reference numbers of the firm's employees who are retail investment advisers (including trainees), and their relevant qualifications.

Disclosure requirements

In the UK, firms have to comply with pre-sale disclosure requirements and point-of-sale requirements.

- Pre-sale: COBS 6.3 requires a Services and Costs disclosure or Combined Initial Disclosure Document to be provided to the customer which sets out, amongst other things, the service the firm is providing (i.e. independent or restricted), the firm's charging structure and information about who regulates the firm.
- Point of sale: Key features document which sets out key information about the product; key features illustration; key investor information document (funds). Information about the cost and cancellation rights should also be provided. Under RDR, firms are required to provide information to the customer about the cost of the advice in "cash terms".

For certain products (packaged products as set out in COBS 9.4.1R) where a personal recommendation is made to a retail customer, a suitability letter is also required. The FCA does not specify a particular format (e.g. a template letter), but the letter must "at least, specify the clients' demands and needs; explain why the firm has concluded that the recommended transaction is suitable for the client having regard to the information provided by the client; and explain any possible disadvantages of the transaction for the client".

Regarding ongoing services provided to retail clients, it is a requirement under the RDR to provide the services for which the adviser is receiving payment for.

Conflicted remuneration prohibitions

Under the RDR, firms must set their own advice charges and agree these with the retail customer. Requirements were introduced to prevent advice firms from receiving commission payments from product providers. This applies to sales after 31 December 2012. COBS 6.1.A. Adviser Charging and Remuneration sets out the requirement for firms to be "remunerated by adviser charges and must not solicit or accept any other commissions, remuneration or benefit of any kind in relation to the personal recommendation." Similarly, the rules in COBS 6.1B.5 prohibit product providers from paying commission in relation to a personal recommendation.

The FCA focuses on both the letter and the spirit of the rules and has issued further guidance on the inducements rules (COBS 2.3) around non-monetary benefits. These may be offered by providers but the emphasis is that these non-monetary benefits must enhance the service to the client.

Conflict of interest arrangements

The regulations around conflicts of interest are set out in the FCA Handbook (SYSC 10). Conflicts may be managed or may be disclosed. For firms who are "vertically integrated" (firms or groups which both manufacture and distribute investment products), there may be conflicts of interest where in-house products or products manufactured by an associate of the firm are held within customers portfolios. The FCA expects firms to be able to demonstrate that those products are suitable for the customer.

5.6 United States

Licensing requirements for financial advice providers

Advisers' obligations to their clients depend on whether they are registered with the Financial Industry Regulatory Authority ("FINRA") or the Securities and Exchange Commission ("SEC"). FINRA-registered advisers – "registered representatives" of securities firms – typically are paid with commissions when investors buy or sell securities. Advisers who charge fees for advice generally are registered investment advisers (RIAs), overseen by either the SEC or state securities regulators. Many financial professionals may be regulated by both FINRA and the SEC, each for a different part of their business. Investors may, therefore, pay the same individual both an advisory fee and trading commissions.

There are no "fit and proper" or educational requirements for registration as an investment adviser, although certain employees of the adviser may have to pass securities exams depending on the state. Instead, advisers must disclose to clients the background and qualifications of certain of their personnel. In addition, advisers to U.S. mutual funds are subject to special requirements under the Investment Company Act, including the annual approval of their fees by the funds' board of trustees.

Each licensee must establish an internal compliance program that addresses the adviser's performance of its fiduciary obligations. This includes written policies and procedures, internal controls, BCP, recordkeeping and an annual review process.

Statutory duties imposed on advice providers

Advisers who charge commissions are required to make sure a product is appropriate for an investor before selling it. RIAs are held to a broad fiduciary standard. This higher standard means that RIAs have an obligation to think about what investments would best serve the client. Fee-only advisers are paid only by their clients, and thus in theory they have no incentive to favour a particular financial product to sell to their clients.

SEC guidance, for example, states that advisers subject to a fiduciary standard have a duty to:

- Make reasonable investment recommendations independent of outside influences;
- Select broker-dealers based on their ability to provide the best execution of trades for accounts where the adviser has authority to select the broker-dealer;
- Make recommendations based on a reasonable inquiry into a client's investment objectives, financial situation, and other factors; and
- Always place client interests ahead of their own interests.

The Advisers Act also imposes specific requirements by rule in a wide range of areas, including, but not limited to, investor solicitations, principal transactions, proxy voting, political contributions and custody/safekeeping of client assets.

Disclosure requirements

Registered advisers are required to prepare and deliver to clients a plain English, narrative brochure that contains all information required by Part 2A of Form ADV, including, among other things, information about the adviser's business practices, investment strategies, fees, conflicts of interest, and disciplinary information. Form ADV is the uniform form used by investment advisers to register with both SEC and state securities authorities.

The adviser must deliver the brochure to a client before or at the time of entering into an advisory contract with the client, and must annually deliver to the client an updated brochure that contains or is accompanied by a summary of material changes, or a summary of material changes with an offer to deliver the updated brochure upon request. In addition, Form ADV contains specific requirements for calculating "regulatory assets under management" and advisers often consult U.S. specialists to confirm the accuracy of their calculations.

Conflicted remuneration prohibitions

The Advisers Act prohibits performance fees, subject to certain exceptions that impose conditions (e.g. relating to a client's new worth) which must be satisfied. In addition, advisers to U.S. mutual funds are subject to special requirements, including annual approvals by the funds' board of trustees of the investment advisory agreement and related fees. This allows for the payment of commissions by the fund to advisers provided the Board of trustees agrees.

Conflict of interest requirements

Advisers must adopt and implement written policies and procedures reasonably designed to prevent the adviser or its personnel from violating the Advisers Act. In designing its policies and procedures, advisers should identify conflicts and other compliance factors creating risk exposure for the firm and its clients in light of the firm's particular operations, and then design policies and procedures that address those risks.

5 Limitations

Statement of Responsibility:

We take responsibility for this report, which is prepared on the basis of the limitations set out below. The matters raised in this report are those which came to our attention during the course of our work, provide results that are indicative only based on our high level comparison and do not necessarily reflect the same accuracy as would be true of a comprehensive benchmarking study.

Limitations:

The purpose of the Report is solely for use by the FSC. The Report is not intended to and should not be used or relied upon by anyone else and we accept no duty of care to any other person or entity. The Report has been prepared for the purpose set out in the Engagement letter dated 2 May 2014. We understand that FSC may provide a copy of our Report to the Inquiry. We agree that a copy of our Report may be provided to the Inquiry for their information only on the basis that we do not accept any duty, liability or responsibility to the Inquiry in relation to this report.

Our work only considers the impact of the specific Future of Financial Advice ("FOFA") reforms, and reforms equivalent to FOFA in the specified jurisdictions, to the extent to which it has been outlined within the scope of this Report. You should not refer to or use our name or the advice for any other purpose. To the maximum extent permitted by law, we are not responsible to you or any other party for any loss you or any other party may suffer in connection with the access to or use of this Report.

Our work does not constitute a reasonable assurance (audit) or limited assurance (review) engagement in accordance with the Auditing and Assurance Standards Board (AUASB) standards and consequently, no assurance is provided. The scope of our work does not extend to obligations not specifically detailed in the Statement of Work and the work described above, and any interpretation of law. No legal opinions are provided or can be assumed.

Deloitte assumes that any information provided by the FSC in relation to enquiries for this Report are true, complete and not misleading, and confirms that if the information is untrue, incorrect or misleading then the Report may be incorrect or inappropriate for its purpose. The decision-making responsibility in response to the content of this Report resides solely with the FSC.

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Roy Morgan Research

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Financial Advice Survey

Prepared for the Financial Services Council

April 2014

Roy Morgan Research – 401 Collins Street, Melbourne VIC 3000

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Background and Methodology

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Background

- The Financial Services Council commissioned Roy Morgan Research to conduct a survey into Australians' perceptions of financial plans and advice.
- The questionnaire covered topics such as:
  - Types of financial advice of interest;
  - Perceived cost of personalised financial plans;
  - Information sources for free financial advice; and
  - Use of financial planner/advisor.

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Methodology

- Online survey, in field Wed 16 April – Tue 22 April 2014
- Nationally representative (age x sex x area) sample of Australians aged 18+
- Final sample size of 1,019 respondents
- Post-weighted (age x sex x region) to the Australian population 18+ using current ABS population estimates

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Key Findings

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Types of Financial Advice and ability to control scope

- Australians want to receive financial advice covering a range of topics – ranging from comprehensive through to issue-specific advice.
- Assuming an acceptable cost, 53% of Australians would want to receive comprehensive financial advice (i.e. advice that covers their entire financial situation).
- Other frequently cited forms of financial advice included:
  - Specific advice about superannuation (32%);
  - Specific advice about investment needs (26%); and
  - Specific advice about insurance (14%).
  - Specific advice about consolidating debts (8%).
  - In total, 53% of Australians would want to receive some form of specific advice
- There is strong agreement amongst Australians that it is within their rights to be able to specify the type and scope of financial advice they receive from a financial planner (65% *strongly agree*; 87% total agree).

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Perceived Cost of Personalised Financial Plan from Financial Advisor

- The populations' perceptions of the cost of personalised financial plans from a financial advisor skew towards lower price ranges, with three-quarters of Australians (76%) expecting a cost below $1,000 for this service.
  - The most frequently reported price expectation was $200-$499 (36%).
  - Only 7% of the population thought a personalised financial plan would cost more than $2,000.
- If faced with a need for a comprehensive financial plan, the vast majority of the population (84%) would not consider paying $2,500 for a personalised plan from a financial advisor.
  - Only 8% indicated a willingness to pay this price, while the same proportion reported that they 'had no idea' (8%).

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Sources of Free Financial Advice

- When asked to consider a situation where they needed financial advice but couldn't afford to pay for it, 69% of the population indicated that they would go to friends/family/acquaintances who had some financial knowledge, while 61% would source financial advice via internet searches.
- Financial blogs were a distant third source for free financial advice (27%), followed by newspapers (16%) and magazines (13%).

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Use of Financial Planner/Advisor

- Around one in five Australians (20%) currently have a financial planner/advisor to help manage their investments.
- The same proportion indicated that despite not currently having a financial planner/advisor, they have had one in the past (20%), while some 61% have never had a financial planner/advisor.

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