The Proposed Amendments to the Future of Financial Advice Reforms:

The Potential For Consumer Detriment

A legal analysis by
Dr Paul O'Shea for
National Seniors Australia

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National Seniors
Australia

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EXECUTIVE SUMMARY

The proposed amendments to the Future of Financial Advice ('FOFA') reforms have the potential to cause considerable detriment to the small retail investors ('consumer investors') which the FOFA reforms were designed to protect. There are few benefits.

1. Removing the 'Opt-in' requirements

Removing the "opt-in" requirements would take away the obligation on financial planners and advisers to contact their clients every two years and obtain express consent to renew their arrangements with their adviser or planner in relation to ongoing commissions and fees.

This represents a major consumer detriment as it takes the onus away from the advisers and puts it on to investors who are far less able to constantly monitor the performance of their portfolios and, therefore, what "on-going" service they receive from their planner for the fees they are charged. It reinstates the "soft lock" on the consumer's commitment to a particular planner, their fee structure and the portfolio of products they advised. General insurance policies are renewed each year: Why not the On-going Fee Arrangements enjoyed by financial planners?

2. Removing the 'catch-all' aspect of the duty to put the client's interests first

The FOFA reforms imposed six prescribed steps on advisers and planners to ensure that they put the client's interest above their own. They also added a 'catch all' obligation to generally always prioritise the client's interests above their own. The six prescribed steps add little if anything to the "reasonable basis" for advice requirement which existed prior to the adoption of the FOFA reforms.

Removing the 'catch-all' aspect of the duty to put the client's interests first will make it easier for advisers and planners to defend actions by investors claiming for their losses. It will basically reinstate the pre-FOFA position.

This proposal, if adopted, would provide advisers and planners with a 'safe harbour' from actions by investors. They could simply say they completed the six prescribed steps and this will be enough. The proposed amendments will cause major consumer detriment by making it harder for consumers to claim for their losses.

3. Exempting General Advice from the ban on Conflicted Remuneration

The government proposes removing the ban on commissions when the adviser is only giving general advice. Under the FOFA reforms, advisers and planners must not receive any commissions or benefits from any investment product issuers whose products they recommend even in a "general" as well as a "personal" advice situation.

Many consumer investors form their initial views about particular investment products from newspaper articles, newsletters, brochures, seminars and other general advice situations. Advisers and planners could still be influenced in their general advice to clients by the promise of commissions and other benefits. At first instance, this probably only represents a minor consumer detriment but, with the consolidation of the financial advising and planning industries, more consumers will get most of their information about investments in the general advice situation. What is minor now could, very soon, become a major consumer detriment.

4. Repeal the back-dating of annual fee disclosure for existing investments.

Removing the annual fee disclosure requirements for pre-1 July 2013 investments is denying the first benefits of the FOFA reforms for existing consumer investors.

Although the FOFA reforms only came into effect on 1 July 2013, advisers and planners must still report annually on their fees and commissions to their clients even though the original advice and investment happened years before then. Combined with the 'opt-in' requirement this puts investors in a good position to monitor the on-going cost of their investment advice and service. The government proposes confining this requirement to new investments only thus removing the benefit of this annual reporting from thousands of already committed retail investors.

This begs the question:

" Why don't advisers and planners want their clients to know, each year, what they are making in commissions and fees on their investments?"

It would not be difficult provide such reports and it is information the advisers and planners already have. On a cost/benefit basis, this proposal presents a major consumer detriment with little saving in administration costs.

5. Widening the Grandfathering Exemptions from the Conflicted Remuneration Ban

Under FOFA, advisers and planners can no longer receive commissions from the issuers of investment products so that their advice to their investor clients is not influenced by the prospect of receiving such commissions.

The 'grandfathering' provisions allow advisers and planners to continue to collect commissions from those investment products issued before 1 July 2013. The government is proposing extending this exemption to:

- any adviser who purchases the business of another. In that situation, the exemption rights of the old adviser will be extended to the new one. Currently, a sale of the adviser's business will result in a loss of the exemption and the new adviser does not receive any product issuer commissions on the older investments.
- any adviser who changes representatives so that even with a new representative in place, the employer/principal adviser continues to receive the commission;

- the situation when an investor client with a superannuation product held before 1 July 2014, then shifts from the growth phase to the pension phase. Currently, this shift would stop the commissions. The government's proposal would allow them to continue.

These proposals will cost existing consumer investors more in commissions and fees but, as they are only an extension of the existing 'grandfathering' exemption, they only represent a minor consumer detriment.

6. Explicitly allowing for the provision of 'scaled advice.'

The effect of this reform is to remove most of the "best interests" duty requirements from the 'scaled advice' situation. It is also described in a misleading manner. FOFA already provides for scaled advice.

The scaled advice option in the FOFA reforms is good for consumer investors because it allows planners and advisers to offer a more limited low cost product. However, removing the consumer protections which were attached to it is fraught with danger.

This proposal represents potentially a major consumer detriment as planners and advisers in the scaled advice situation can simply advance a particular product to a consumer investor without considering the consumer's overall position.

1. Introduction

1.1 Background

In response to a series of highly publicised instances of perceived market failure, such as the Storm Financial, Opus Prime and Trio collapses, and as part of its election program, the Federal ALP Government announced in April, 2010 a reform package entitled "The Future of Financial Advice" ('FOFA').

After extensive consultations, including an inquiry by the Joint Parliamentary Committee into Corporations and Financial Services, these reforms were enacted as the *Corporations Amendment (Future of Financial Advice) Act* which substantially made amendments to Part 7 of the *Corporations Act 2001 (Cth) (As Amended)* ('the Act') which deals with financial services. The FOFA reforms became effective on 1 July 2013.

The newly elected Coalition Government on 20 December 2013, through the Assistant Treasurer, Senator the Hon Arthur Sinodinos AO, announced a package of changes to FOFA, including:

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

The Government's intended approach is that time sensitive amendments will be dealt with through regulations, to the extent allowed under the relevant regulation-making powers, and then locked into legislation. The Government intends enacting the regulations before the end of March 2014. It has already introduced its Bill into the House of Representatives.

1.2 The Author

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1.3 Consumer Investors

The FOFA reforms were aimed at protecting small investors. As Commonwealth Treasury said: "The objectives of FOFA are to improve the trust and confidence of Australian retail investors in the financial services sector and improve access to advice."[1] These were the most poignant victims of infamous market failures such as Storm Financial and Opus Prime. While there is no age limit or restriction on investment, until consumers have acquired either cash or cash convertible assets, such as superannuation, they often do not seek out the services of financial planners or advisers. Whether this is wise or not, it does result in the age demographic of the persons most affected by the FOFA reforms being dominated by persons over 50. What is significant here is that market failure at that age or older leaves the consumer with very little or no working life to recover their overall capital position. The integrity of the financial advice system for these consumer investors, therefore, is pivotal to not only their financial health but their overall well-being as they move into the last part of their lives.

"Retail investors" can be equated with "consumers". Both sections of their respective markets need special protections to overcome the structural inequalities of information, bargaining power and litigious power which exist in the retail investment market. To some extent this premise rests on definitions of "consumer." The "consumer" is not a creature known to the common law. In the absence of a statutory insistence that they do so, judges have not attempted to define or even describe in a collectively acceptable way, the characteristics of a consumer. The word "consumer" was not defined in older law dictionaries.[2] More recent versions do so while reciting various statutory formulae.[3] There have been an increasing number of these[4] and such statutes increasingly extended hitherto exclusively "consumer" rights to "small business."[5] The *National Consumer Credit Protection Act 2009* specifically extended its consumer protections

[1] Commonwealth Treasury *Future of Financial Advice – Homepage* at http://futureofadvice.treasury.gov.au/Content/Content.aspx?doc=home.htm at 15/3/2013

[2] E.g. Oppe, A (ed), *Wharton's Law Lexicon* (Stevens, 14th ed, 1938) and in the United States, Rawle, F (ed), *Bouvier's Law Dictionary* (West Publishing, 8th ed, 1914) and as late as Burke, J (ed), *Osborn's Concise Law Dictionary* (Sweet & Maxell, 6th ed, 1976).

[3] Bishop, J, *Blackstone's Australian Legal Words and Phrases* (Blackstone Press, 1993) 57: "a person who purchases goods of a kind ordinarily acquired for personal, domestic or household use or consumption" and Butt, P (ed), *Butterworths Concise Australian Legal Dictionary* (LexisNexis, 3rd ed, 2004) 90 "a person who acquires goods or services for a non-commercial purpose." and, in the United States, from the same publisher as the earlier *Bouvier's*, Garner, B (ed), *Black's Law Dictionary* (West Publishing, 7th ed, 1999) 311.

[4] In Australia, the ACL s 3 and the *Australian Securities and Investments Commission Act 2001* (Cth) ("ASIC Act") s 12BC and in Europe the *Council Directive 93/13/EC* of 5 April 1993 on *Unfair Terms in Consumer Contracts* [1993] OJ L 95/29, art 2(a)

[5] ACL s22 and ASIC Act s 12 BC.

[6] *National Consumer Credit Protection Act 2009* (Cth) Schedule 1, Section 5(1)(b).

to individual persons investing in residential housing.[6] The law now recognises small investors as consumers.

The special status of "retail investors" was recognised from the beginning of the Financial Services Reforms initiated by the Wallis Report. These were then enacted as provisions of the Financial Services parts of the Act which provides increased protection, over and above its other provisions, for "retail investors". A person can qualify as a "retail investor", and for the purposes of this paper, a "consumer investor", if they are one of the following:

a. Earning less than $250,000 per year with assets less than $2.5 million and not investing in connection with a business and investing less than $500,000.

b. Investing in connection with a small business which, if in manufacturing, employees less than 100 people or otherwise less than 20 people and the investment is less than $500,000.[7]

Such retail investors often lack relevant:

- experience;
- knowledge;
- training;
- money management skills.

They suffer from the "irrational optimism" identified by behavioural economics as a common characteristic of consumers which calls for special market protections.[8] They are frequently highly reliant on the advice and guidance of their financial advisors and financial planners. For good reason, the law treats these investors differently from "wholesale investors" and this paper will refer to them as "consumer investors."

1.4 Assessment Criteria

The proposed changes to FOFA will be assessed according to the following criteria:

A. Consumer Benefit

The proposed change will enhance consumer investor protection above the position above that which is in place as a result of FOFA or the pre-existing law.

B. Neutral Consumer Position

The proposed change will neither enhance nor detract or undermine consumer investor protection from the FOFA position.

[7] *Corporations Act 2001* (Cth) s 716G.

[8] Sunstein, C and Thaler, R 'Libertarian Paternalism is not an Oxymoron' (Working Paper No 43, Public Law and Legal Theory Workshop, University of Chicago Law School, May 2003) http://www.law.uchicago.edu/publications/papers/publiclaw Camerer, C et al, 'Regulation for Conservatives and the Case for "Asymmetric Paternalism"' (2003) 151 *University of Pennsylvania Law Review* 1211–1254.

[8] Korobkin, R, and Ulen T, 'Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics' (2000) 88(4) *California Law Review* 1051-1144

C. Minor Consumer Detriment

The proposed change will potentially:

- cost consumer investors more in fees, commissions or other charges;
- reduce the amount, quality and frequency of provision of information to consumer investors;
- reduce or mitigate the rights of consumers to claim for their investment losses where appropriate.
- compromise the independence of advice and information given to consumer investors;

in a relatively minor way in the overall context of the FOFA reforms including the possible benefits to industry through reduction of administrative costs.

D. Major Consumer Detriment

The proposed change will more likely than not:

- compromise the independence of advice and information given to consumer investors;
- cost consumer investors more in fees, commissions or other charges;
- reduce the amount, quality and frequency of provision of information to consumer investors;
- reduce or mitigate the rights of consumers to claim for their investment losses where appropriate;

in significant ways which are not justified in the overall context of the FOFA reforms including any putative benefits to industry through reduction in administrative costs.

2. Removing the Opt-in Requirements

2.1 The Pre-FOFA Position: The "soft lock"

Prior to the FOFA reforms, when advisers and financial planners gave personal advice to their clients, under the Corporations Act, this advice was contained in the Statement of Advice ('SOA'). The SOA was required, among other things, to disclose to the consumer investor what commissions, fees and charges were being paid to the adviser or planner from all sources.[9]

Then, as now, an SOA must generally be given to a client when, or as soon as practicable after, the advice is provided and, in any event, before the investment is made. In time critical cases the SOA must be provided within five days of implementation. SOAs must be worded and presented in a clear, concise and effective manner and contain the level of detail that a client would reasonably require to decide whether to act on the advice. Advisers recommending a product to a retail client must also provide a Product Disclosure Statement ('PDS') at or before the time that the adviser provides the advice.[10]

There was, pre-FOFA, no precise statutory or regulatory obligation to "update" this advice. Nor was there an obligation to regularly contact the client to ensure that they were happy with their investments and that were happy for the adviser or planner to continue to receive commissions and fees whether directly from the client or, as was possible pre-FOFA, from the issuers of the products chosen by the client on the advice of the planner.

The Financial Planning Association Code of Professional Practice, applicable pre-FOFA, refers to "Reviews of the Client's Situation"[11] and to ongoing duties of disclosure in relation to engagement and conflicts of interest.[12] These, however, were matters of negotiation and agreement between the client and the planner or were prompted by changes which, in the planner's view, warranted contacting the client. There was no requirement for regular reviews.

While consumers did have the opportunity to renegotiate the terms of their engagement of advisers and planners (subject to contractual notice requirements), these were rarely taken up. The relationships were long term and the "opt out" was largely illusory.

2.2 The Current FOFA Position: Renewal Every Two Years

Under FOFA, planners and advisers must provide their clients on each second anniversary of the provision of their original Fee Disclosure Statement with a new Fee Disclosure Statement and a Renewal Notice which must, among other things, inform the client that they have a choice whether to renew their fee arrangements with the planner or not.[13] The Fee Disclosure Statement states all the fees and commissions received by the adviser or planner from the client or the client's investments within the previous 12 months.

9 *Corporations Act 2001 (Cth)(As Amended)* ('CA') section 946A

10 CA sections 946C(3); 947C(6); 947B(3) and 947C(3)

11 FPA Code of Professional Practice July 2011 version at http://www.fpa.asn.au/media/FPA/pdf-2011/Code-of-Professional-Practice-July-2011.pdf at p 18

12 Ibid p 20

13 CA s962K

The client has 30 days to respond and if they do not do so, they are to be taken to have not renewed.[14] This is, therefore, an "opt-in" arrangement. If the client does not "opt-in" the Act stipulates that the On-going Fee arrangement is at an end and the Fee Recipient, that is the planner or adviser, can no longer collect fees from the client or their investments.[15]

2.3 Analysis of the FOFA Position

The imposition of the requirement for bi-annual renewals did lead to considerable "tooling up" costs for planners and advisers. Also, the Act is quite prescriptive about the relevant anniversary dates for the provision of the Renewal Notices and there are civil penalties for failing to provide them on time.[16] Calculation of the appropriate dates has proved problematic for some advisers and planners as the relevant date for Fee Disclosure and, therefore, Renewal is not described in the same way as that for provision of other disclosure documents such as SOAs.

However, the process of "tooling up" for such compliance is now complete or almost complete for most advisers and planners. Their systems are now programmed to produce Fee Disclosure Statements and Renewal Notices. It is unlikely that the provision of these notices and the administration of the exercise of the client's choice to renew is likely to impose a significant on-going cost on industry. Of course, the risk of losing the client due to their dissatisfaction with their investments or the level of fees and commissions is another matter. This is a risk which, arguably, industry should bear.

The analogy can easily be drawn between the provision of bi-annual Renewal Notices and annual general insurance policy renewals as regulated by the *Insurance Contracts Act 1984*.[17] Failure to properly notify the insured of both the need to renew their policy and of their ongoing disclosure requirements carries consequences for insurance companies. Insurance companies are accustomed to an annual process of notification, scrutiny of their product and its price, possibly competitive comparisons by consumers leading to either renewal or loss of custom.[18]

Why should not advisers and planners, who are also offering a financial service, be subject to a similar discipline? This is the kind of regulation which facilitates an efficient market by empowering consumers to make informed choices. Those choices, it is argued, should not be singular leading to almost a life-time commitment but rather periodic and subject to regular review.

[14] CA s962N

[15] CA s962N,P and Q

[16] CA 962P and 1317E create a Civil Penalty.

[17] See ss58-60 et al.

[18] The distinction needs to be drawn between general insurance, where annual renewal is required, and life insurance, where it is not. Investment advice is more akin to the former as the factors which affect the outcome for the consumer are almost all beyond their control and are susceptible to frequent changes over the life of the investment. Life insurance, on the other hand, depends on actuarial variables calculated at the beginning of the investment which, largely, remain constant throughout the insured life.

2.4 The Proposal: Back to the Future

The *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* ('the Bill') provides at Clause 22 for the repeal of Sections 962K-N. The proposal is to completely remove the "opt-in" requirements.

This will take consumer investors back to the pre-FOFA position in relation to on-going fee arrangements. Their agreements with their advisers and planners will return to the contracts of adhesion that they once were. They may still "opt out" but the burden of initiating that process will rest with them.

2.5 Assessment of Consumer Detriment of the Opt-Out Proposal

Given the structural disadvantages of consumers discussed above, it is inequitable to place the burden of considering and renewing their on-going fee arrangements with their advisers and planners on them. It is more appropriate that this rests with the licence holders who stand to gain the most from those arrangements.

Returning to the pre-FOFA position on this matter represents a **major consumer detriment.**

3. Removing the 'catch-all' aspect of the duty to put the client's interests first

3.1 The Situation Pre-FOFA: Conflicts with Competence and Candour

Prior to the FOFA reforms, advisers and planners in their advice to clients were subject to a:

- statutory duty to act "efficiently, honestly and fairly";[19]
- common law duty against negligence;
- statutory duty to disclose the sources of their commissions.

Provided a planner fulfilled these obligations, they could, and frequently did, choose to recommend to clients investment products from which they, the planner, received more commissions than other products. The incentive was always there to choose those products which provided the most remuneration. The effect of this incentive on the planner's advice was almost impossible to discern. The consumer might never know.

This remuneration could be from commissions paid by the product issuers (now banned under FOFA) or by the client or in the form of on-going service fees.

3.1.1 The Problem with Complaints

The biggest problem with complaints by consumer investors is their paucity by comparison with the number of consumer investors who suffer losses and who may have grounds for complaint. There are several reasons for this including:

- consumers will not know whether there were more suitable products in the market place at the time the received their advice. They relied on the planner.
- fear of appearing foolish;
- an on-going relationship with the adviser or planner;
- advice from the planner to "hang in" in the hope that investment performance will improve;
- a lack of familiarity with their legal rights, alienation from the courts and legal system generally and a lack of knowledge and understanding of the available alternative dispute resolution processes.

All of these combine to make the instances of consumer complaints about negligent advice by planners far less frequent, by most industry and regulator estimates, than their actual occurrence in the market.

3.1.2 The Problem with Disclosure

Disclosing commissions to consumer investors in formal documents, such as the SOA, is frequently ineffective to adequately alert consumers to the possible relationships between planner advice and planner remuneration. This applies both when that remuneration comes from product issuers (which is now banned under FOFA) or from consumers themselves.

[19] CA section 912A

Empirical research by this author has established in the consumer credit area that comprehensive documentary pre-contractual disclosure is a largely ineffective means of overcoming the structural inequality of access to information for consumers. This was so across a wide range of demographics and depended less on education and income than on relevant product experience.[20] As Professor Justin Malbon of Monash University has said: "Simply giving consumers lots of pieces of paper is a waste of everybody's time."[21] Logically, this is also the case for consumer investors.

It was no answer then, pre-FOFA, nor is it now to say that "Provided all the commissions and fees are disclosed, it doesn't matter that the planner recommends the product which provides them with the most remuneration." Disclosure alone is never enough.

3.1.3 The limitations of the Pre-FOFA obligations

a. The statutory obligation

The relevant statutory obligations for advisers and financial planners in relation to the "standard of advice" were contained in two sections of the Act:

- Section 912A which requires that all financial services are delivered "efficiently, honestly and fairly"; and
- Section 945A(1) (now repealed) ***requirement to have a reasonable basis for the advice [personal advice only]***

The providing entity must only provide the advice to the client if:

(a) the providing entity:

(i) determines the relevant personal circumstances in relation to giving the advice; and

(ii) makes reasonable inquiries in relation to those personal circumstances; and

(b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and,

(c) the advice is appropriate to the client, having regard to that consideration and investigation"

[20] O'Shea, P Simplification of Pre-Contractual Disclosure in Consumer Credit: Empirical Research and Redesign, Uniquest, 2010, Report for the Ministerial Council for Consumer Affairs.

[21] Malbon, J, 'Shopping for Credit: Empirical Study of Consumer Decision-making', (2001) 29 Australian Business Law Review 44

In other words:

- know your client's circumstances;
- verify what they tell you;
- know your products and the other subject matters of your advice;
- consider the two together; and
- advice the client accordingly.

Whether the adviser or planner received more or less commission from a particular product was largely irrelevant to these two obligations as stated and as examined by courts and external dispute resolution schemes handling investor complaints. It defies common sense, however, to suggest that larger commissions did not influence adviser actions and advice.

There was, to some extent, a "disconnect" between the legal obligations of advisers and the human reality of their motivations. The "Client's Interests" Duty and the "priority" obligation imposed by FOFA made this connection.

b. The Common Law

The Act did not replace the common law which still described the content of the duty of care for advisers. Like most negligence duties, it was described in terms of "reasonable care and skill."[22] As Justice Hasluck said:

"Where a professional provides a service to a client, in the absence of an express term to the contrary, an implied term of the contract under which the service is supplied is that the professional will exercise reasonable care and skill in providing the service. Where there is a contract, the extent of the professional's liability to the client may depend upon or be affected by the terms of the contract. The terms may confine or exclude the existence of a duty of care owed by one part to the other: see generally Walmsley, Abadee & Zipser: "Professional Liability in Australia" at par 1.30 to par 1.320."[23]

Industry standards were crucial in such assessments as indicated by the discussion of financial service licensees in the 7th edition of *Securities and Financial Services Law* by Baxt, Black and Hanrahan at paragraph 15.11. The authors describe that duty of care as one that is to be measured having regard to what is reasonable in the circumstances as follows:

"Although a financial services licensee is not required to have an extraordinary level of skill or the highest professional attainments, it must exercise due care, skill and diligence, and must bring to the task the competence which is usual among persons practicing as financial services licensees. See ***Voli v Inglewood Shire Council*** *(1963) 110 CLR 74 per Windeyer J at 84;* ***Midland Bank Trust Co Ltd v Hett, Stubbs & Kemp*** *[1979] 1 Ch 384 at 403;* ***Rogers v Whittaker*** *(1992) 175 CLR 479; 109 ALR 625."*

These descriptions of the duty are about competence and care. They say nothing about conflicted remuneration and the effect it may have on the quality of advice.

[22] Carmody v Priestly & Morris Perth Pty Ltd [2005] WASC [93] per Hasluck J.
[23] ibid

c. The obligation of disclosure

The possible sources of remuneration for an adviser or planner are disclosed in three documents provided at different times in the advice process:

1. The Financial Services Guide;[24]
2. The Statement of Advice[25]; and
3. The Product Disclosure Statement.[26]

The limitations on the effectiveness of disclosure to consumers were discussed above. These problems are particularly acute with the volume and complexity of these documents. ASIC produced a sample Statement of Advice in 2005 which only dealt with a scenario involving investment in a managed fund, basic deposit products and personal insurance. This document was meant to be an example of "clear and concise" advice and ASIC was clearly proud that it was only 20 pages long.[27] Many SOA's dealing with more complex investment products combined with insurance and other financial services run to more than twice that length. Combined with Financial Services Guides and glossy, impressive Product Disclosure Statements, new consumer investors can face hundreds of pages of reading.

Little wonder that they frequently overlook important details such as the remuneration of their adviser.

3.1.4 Summary of the Pre-FOFA position

As discussed above, the statutory and common law protections for consumer investors pre-FOFA focussed on the competence and candour of the adviser and not on the potential conflicts of interest produced by the influence of commissions on the quality of financial advice. It is no surprise that this advice was sometimes "sub-optimal"and produced scandals such as Storm Financial, Optus Prime and Westpoint.

3.2 FOFA Changes the Focus: Duty to the Consumer's Interest

3.2.1 The Repeal

FOFA repealed the "reasonable basis" section and replaced it with:

961G Resulting advice must be appropriate to the client

The provider must only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client, had the provider satisfied the duty under section 961B to act in the best interests of the client.

This rather circular drafting seems to test the "appropriateness" of the advice on the basis of compliance with the new "best interests" duty.

[24] CA 941D
[25] CA 946A
[26] 1012A
[27] ASIC RG 90 Example Statement of Advice for a Limited Financial Advice Scenario for a New Client, 2005.

3.2.2 The New Duty

FOFA provides for a new obligation to act in the best interests of the client as follows:

961B Provider must act in the best interests of the client

(1) The provider must act in the best interests of the client in relation to the advice.

(2) The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:

(a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;

(b) identified:

(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and

(ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the **client's relevant circumstances***);*

(c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;

(d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;

(e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:

(i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and

(ii) assessed the information gathered in the investigation;

(f) based all judgements in advising the client on the client's relevant circumstances;

(g) taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

961E What would reasonably be regarded as in the best interests of the client?

It would reasonably be regarded as in the best interests of the client to take a step, if a person with a reasonable level of expertise in the subject matter of the advice that has been sought by the client, exercising care and objectively assessing the client's relevant circumstances, would regard it as in the best interests of the client, given the client's relevant circumstances, to take that step.

There are exceptions to the "best interests" duty for basic banking products and general insurance.[28] The government proposes broadening these exceptions and this will be discussed below.

This has, in some respects, shifted the focus from the conduct, care, competence and candour of the adviser or planner and put it on the "best interests" of the client. It is an objective test which depends on all the circumstances including the perspective of the consumer investor.

If there is any doubt about the intention of the FOFA legislation, this is, to some extent resolved by section 961 J as follows:

> 961J Conflict between client's interests and those of provider, licensee, authorised representative or associates
>
> (1) *If the provider knows, or reasonably ought to know, that there is a conflict between the interests of the client and the interests of:*
>
> (a) *the provider; or*
>
> (b) *an associate of the provider; or*
>
> (c) *a financial services licensee of whom the provider is a representative; or*
>
> (d) *an associate of a financial services licensee of whom the provider is a representative; or*
>
> (e) *an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee; or*
>
> (f) *an associate of an authorised representative who has authorised the provider, under subsection 916B(3), to provide a specified financial service or financial services on behalf of a financial services licensee;*
>
> *the provider must give priority to the client's interests when giving the advice.*
>
> *Note: A responsible licensee or an authorised representative may contravene a civil penalty provision if a provider fails to comply with this section (see sections 961K and 961Q). The provider may be subject to a banning order (see section 920A).*
>
> (2) *Subsection (1) does not apply if:*
>
> (a) *the subject matter of the advice sought by the client is solely a basic banking product; and*
>
> (b) *the provider is an agent or employee of an Australian ADI, or otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI.*

[28] CA s916B(3) and (4)

(3) Subsection (1) does not apply if the subject matter of the advice sought by the client is solely a general insurance product.

This puts into sharper focus the potential for "sub-optimal" advice being influenced by the potential benefits available to the adviser or planner. Now, it is the client's interests which must be paramount. Anything below that standard is a breach of the statutory duty of the adviser.

3.3 Analysis of the FOFA Position: The "safe harbours" + a "catch all"

3.3.1 The "safe harbours"

Despite the "general" duty in section 961B(1), advisers and planners are held to have satisfied that duty if they prove that they have done all the things listed in section 961(B)(2). In other words, as ASIC said in Regulatory Guide 175, "Section 961B(2) sets out a 'safe harbour' for complying with the best interests duty in s961B(1)."[29]

ASIC points out, however, that "Showing that all of the elements in s961B(2) have been met is one way for an advice provider to satisfy the duty in s961B(1). However, it is not the only way."[30] This is quite correct as the Revised Explanatory Memorandum which accompanied the FOFA bill into the Parliament said:

It is expected that the interpretation of the general obligation in subsection (1) will be informed by the steps set out in subsection (2). Those steps provide an indication of what, as a minimum, is expected of [advice] providers in order to be considered to have acted in the best interests of the client.[31]

ASIC expects that:

Consistent with these statements, advice providers must carry out the steps in s961B(2) (a)–(g)or other steps that would, at a minimum, produce at least the same standard of advice for the client as if s961B(2) had been complied with whenever they provide personal advice to a client.[32]

3.3.2 Comparing the "safe harbours" with the old "reasonable basis" requirements.

The section 961B(2)(a)-(f) safe harbours impose effectively the same standards on advisers as did the old "reasonable inquiries" requirement in the now repealed section 945A.

a. Section 961B(2)(a), (b) and (c) do little more than require the adviser to know their client's relevant circumstances either from what the client tells them and/or what they reasonably find out from other investigations. This is the same as the "know your client" provisions under the previous law.

[29] ASIC RG 175.238
[30] ASIC RG 175.239
[31] Revised Explanatory Memorandum, FOFA Bill, para 1.25.
[32] ASIC RG 175.241

b. Section 961B(2)(d) requires the adviser to consider whether they have the required competence to provide the advice. This is a matter for their licence compliance. ASIC Regulatory Guide 146 deals with the training requirements of licence holders and their authorised representatives. It is difficult to see how this "safe harbour" element of the "Best Interests" duty adds much at all to the existing minimum training and competency requirements required to hold the relevant Australian Financial Services Licence.

c. Section 961B(2)(e) and (f) simply require the adviser to reasonably investigate the relevant financial products and only recommend those to the client which are, in their judgement, suitable for the client's circumstances. It is difficult to see how this is any different to the requirements of the old section 945A(1)(b) and (c) (See above).

3.3.3 The only real difference: the "catch all"

Section 961B(2)(g) adds, as one of the potential "safe harbours", that, having done all of the previous six steps, the planner or adviser has *"taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances"*

So if, in the opinion of a court or other external dispute resolution scheme such as the Financial Ombudsman Service, there was any other thing which the adviser or planner should have done, which was in the best interests of the client, apart from the six "safe harbour" steps, then the adviser has, potentially, not fulfilled their best interest obligation.

This is, arguably, the only substantial difference between the FOFA "best interests" obligation and the old pre-FOFA "reasonable basis" requirement.

3.4 The Government's Proposal: Remove the "Catch-all" and adjust the "safe harbour"

3.4.1 Remove the "catch all"

Section 12 of the Bill repeals Section 916B(2)(g).

The Explanatory Memorandum to the Bill says:

> *This amendment addresses concerns that the catch-all provision creates significant legal uncertainty and renders the safe harbour unworkable for providers due to its open-ended nature.*[33]

3.4.2 Remove the "other step" definition

Section 916E to be repealed

[33] Explanatory Memorandum to the Billpara 1.4

3.4.3 Another adjustment

Sections 10 and 11 of the Bill repeal section 916B(2)(a) and replace it with a new 916B(2)(ba) as follows:

> *(ba) identified the objectives, financial situation and needs of the client that are disclosed to the provider by the client;*

3.5 Analysis of the Government's Proposal: Back to the Future Again

3.5.1 Removing the 'catch all'

The government's argument, as contained in the Explanatory Memorandum, that the "catch all" is too "open ended" and that it creates "uncertainty" flies in the face of large bodies of statute and common law that create such open ended duties in order to flexibly protect consumer rights or other values.

For instance, the general duty of care in negligence, was originally stated by Lord Aitkin as:

> *You must take reasonable care to avoid acts or omissions which you can reasonably foresee would likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be- persons who are so closely and directly affected by my act that I ought to reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.*[34]

This very open ended maxim is the foundation of the modern law of negligence which has assumed prime importance in the law of torts and dominates the work of courts throughout the common law world.[35]

To suggest that it is too "open ended" to impose on advisers and planners the obligation to, themselves, consider what steps they need to take to better their client's position is to deny that advisers and planners are members of a profession with professional obligations. It is to reduce their obligation to merely "ticking the boxes" of the six "safe harbour" steps and recording that they have done so.

Indeed, it is a case involving professional advisers in the area of financial services which prompted the remarks of Justice Hasluck cited above which referred to "reasonable care and skill" usually expected of persons of that profession. These are the benchmarks against which professional services are measured in the context of complaints about the standard of their delivery. Section 9162B(g) is, in this company, a very precise and clear statement which, not only provides guidance to industry but, more importantly, to any court or ombudsman considering a complaint brought by a consumer investor.

[34] *Donoghue v Stevenson* [1932] AC 562 at p 580
[35] *Turner, C Australian Commercial Law* (25th ed), Law Book Company, 1999, p 825

Removing section 9162B(g) makes it easier for adviser and planners to defend a claim for negligent advice or advice that was not in the best interests of the client.

It will reduce the "client's interests" obligation to little more than a methodical restatement of the pre-FOFA position. To do so represents a significant step backward for consumer investors. It raises the potential for **major consumer detriment**.

3.5.2 Adjusting "instructions"

Under FOFA, the obligation to take note of the client's circumstances was defined as being that information provided by the client to the adviser "through instructions." This could have been interpreted in a restrictive way to the detriment of consumer investors and the government proposed amendment would remove the potential for this restriction.

This proposal, therefore, presents some **consumer benefit**.

4. Exempting General Advice from the Ban on Conflicted Remuneration

It is now accepted by all stakeholders that so-called "conflicted remuneration" has the continuous potential to undermine the quality and independence of financial advice. As ASIC said in its submission to the Parliamentary Joint Committee of Financial Services and Corporations inquiry, referred to in the introduction:

> *Commission payments can create real and potential conflicts of interest for advisers. They could encourage advisers to sell products rather than give strategic advice (e.g. advice to the client that they should pay off their mortgage), even if the advice is in the best interests of the client and low-risk. Commissions also provide an incentive to recommend products that may be inappropriate but are linked to higher commissions.*[36]

The Financial Planning Association itself has said, in its submission on the Exposure Draft:

> *It is undeniable that conflicted remuneration has eroded public confidence in our financial system….As stated above, commissions encourage advisers to sell products rather than give strategic advice.*[37]

4.1 Pre-FOFA: No restrictions on General Advice

Commissions paid by product issuers were not banned prior to the FOFA reforms. As discussed above, consumer investors were only protected from conflicted remuneration by its disclosure. Under the Act, a distinction was drawn between "general advice" and "personal advice." The latter involved consideration of the client's individual circumstances and the latter did not.[38]

A financial services provider need only give a client a Financial Services Guide ("FSG") when giving general advice. FSG's did disclose possible sources of remuneration, including product issuer commissions, but did not have to relate those to any particular product or piece of advice about those products. They were, therefore, largely ineffective to alert the recipient of general advice to the presence of any conflicted remuneration which may affect the quality or influence the content of that advice.

An adviser or planner could give general advice receiving substantial benefits from the issuers of the products discussed in that advice with almost no consequences unless that advice proved to be so extremely wrong that is breached the s912A obligation to deliver all financial services "efficiently, honestly and fairly." That rarely happened.

36 ASIC, Submission to PJC Inquiry, at p 168

37 FPA Submission to Treasury, 14 February 2014, at http://www.fpa.asn.au/media/FPA/Policy/2014_02_19_FPA%20Submission_Exposure%20Draft%20FoFA%20Amendments_FINAL.pdf accessed on 20/3/14

38 CA section 766B

4.2 FOFA banned Conflicted Remuneration for General and Personal Advice

4.2.1 The ban

Section 963E of the Act as amended by FOFA bans all conflicted remuneration.

4.2.1 The definition

> 963A Conflicted remuneration
>
> *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 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; or*
>
> *(b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.*
>
> "Financial product advice" includes general advice.

4.3 Analysis of the Ban

Many consumer investors form their initial views about particular investment products from newspaper articles, newsletters, brochures, seminars and other general advice situations. Without the conflicted remuneration ban, they will not be alerted to the possibility that this advice may be influenced by commissions, fees or perhaps "soft money" incentives such as training, conferences, airfares accommodation, catering and even outright gifts.

As ASIC has said:

> *Our research has indicated that marketing information plays a particularly strong role in product distribution and may influence investors' decision making more than other product disclosure. In particular, when investors approach product issuers or other intermediaries responsible for selling products directly, rather than going through advisers, the information contained or implied in product issuers' marketing information is often the first, and may be the only, information that investors use to decide whether or not to invest in that product.*[39]

While much of the focus of the FOFA reforms was on the financial advisers and financial planners, it must be recognised that increasing numbers of consumer investors are purchasing investment products directly from the issuers, particularly the Banks and large insurance companies. If the consumer investor has been directed to that product by information they have gathered in a "general advice" situation it will be very difficult for them to discern whether that advice was unduly influenced by conflicted remuneration.

[39] ASIC, *'Report 384 – Regulating Complex Products'* (January 2014), at para 46

Product Disclosure Statements ('PDSs') are required to disclose whether commissions which will impact directly on the return to the consumer investor who purchases the product. This covered any commissions which were formerly are paid to advisers and planners.[40] These, of course, are now banned by FOFA.

PDSs do not have to disclose, however, a commission or benefit given to an adviser providing general advice only as they will not be directly attributable to the returns for the individual consumer investor. Conflicted Remuneration in general advice can be a "hidden" influence for sub-optimal advice. FOFA prevents this.

4.4 The Government's Proposal: Return Hidden Commissions to General Advice

4.4.1 The Bill provides for the addition of the following:

> *(3) Despite section 963A, a monetary benefit given to a financial services licensee who provides financial product advice to persons as retail clients is not* ***conflicted remuneration*** *if:*
>
> *(a) the benefit is given to the licensee in relation to the issue or sale of a financial product to a person; and*
>
> *(b) personal advice in relation to the product, or products of that class, has not been given to the person as a retail client by the licensee, or a representative of the licensee, in the 12 months immediately before the benefit is given.*[41]

4.4.2 The Employee Exemptions

Employees of Authorised Deposit Taking Institutions ('ADI's), this is mostly the banks, are further exempted when they receive incentives, commission or bonuses from their employer for selling certain products.

963D Benefits for employees etc. of ADIs

> *(1) This section applies if:*
>
> *(a) a monetary or non monetary benefit is given to a financial services licensee, or a representative of a financial services licensee; and*
>
> *(b) the benefit is in whole or in part remuneration for work carried out, or to be carried out, by the licensee or representative:*
>
> *(i) as an agent or employee of an Australian ADI; or*
>
> *(ii) in otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI.*

[40] CA section 1013E

[41] The clause also adds a sub-section (4) which extends (3) to include representatives of licensees.

(2) If:

(a) access to the benefit, or the amount of the benefit, is in whole or in part dependent on the licensee or representative recommending:

(i) a basic banking product; or

(ii) a general insurance product; or

(iii) consumer credit insurance; and

(b) the licensee or representative does not, in the course of recommending any, or any combination, of those products give other ***personal advice*** *that does not relate to any of those products;*

to the extent that the benefit relates to the recommendation of any, or any combination of, the products mentioned in paragraph (a), the benefit is not ***conflicted remuneration****.*

There is a key difference here between the Bill (above) as presented to the parliament and the Exposure Draft released earlier. The latter said:

(d) the licensee or representative does not, in the course of recommending any, or any combination, of those products give other ***financial product advice*** *that does not relate to any of those products;*

This Bill as presented is for consumers, an improvement, somewhat, as it restricts the latitude for employees of banks, receiving commission or bonuses for selling financial products, from straying into "personal advice" without necessarily selling another product.

4.5 Analysis of the Proposals

At first instance, the problem of conflicted remuneration does not seem as acute for 'general advice' as for 'personal advice'. In fact, in some ways it is potentially worse. This is because the disclosure requirements for personal advice both before and after the FOFA reforms are not as detailed and rigorous for general advice as for personal advice. Consumers, therefore, were less likely to be aware of potential conflicts influence the quality of general advice.

Even before FOFA, there was evidence of growing consolidation of the financial planning and advising industries.[42] Since then the trend has continued. As the Financial Planning Association has said:

Furthermore, only one in five Australians receive personal financial advice, compared to the massive volume of general advice available to the retail investor. If general advice does not persuade individuals to a decision, then there would be little incentive or basis for paying employees and licensees through conflicted remuneration on general advice.[43]

[42] Mark Rantall, CEO of the Financial Planning Association, as quoted in "Dawn of the Age of Consolidation in Financial Plannint", 4 April 2013, *Australian Financial Review*.

[43] FPA n 38 above p 10

More and more consumer investors will get their information about investment products from general advice rather than personal advice. More and more of this will come from product issuers themselves, such as banks and large insurance companies, as they “bypass” the personal advice offered by financial planners and sell directly to the public. Exempting conflicted remuneration in these situations will encourage more aggressive and potentially more misleading sales techniques.

Indeed, the government itself envisages its amendment to encourage more general advice. The Regulatory Impact Statement for the proposed amendments says:

> *In addition, this amendment is likely to increase the prevalence of general advice as allowing commissions would facilitate its delivery. To the extent that general advice increases engagement and awareness of financial products, consumers may be better informed.*[44]

What they won’t be better informed about is the sources of remuneration of the person giving them the general advice.

Removing the ban on conflicted remuneration represents a major consumer detriment. Extending the exemption for conflicted remuneration to include those sales situations where employees of product issuers are selling financial products to consumers is, likewise, a major consumer detriment.

[44] RIS at para 27

5. Repeal the back-dating of annual fee disclosure for existing investments.

5.1 Pre-FOFA

As discussed above, pre-FOFA, the Act did not require annual fee statements for planners and advisers who collected on-going fees from their client's investments. Such disclosure was left up to the discretion of the planner and often was only referred to in reviews of their client's portfolios which gave them an opportunity to sell them new products from which they could collect new commissions.

5.2 FOFA

As discussed above, FOFA requires Fee Disclosure Statements for any on-going fee arrangements. This applies to all investments whether entered into before 1 July 2013, the commencement date of FOFA or after.

5.3 The Government's Proposal: Grandfathering Disclosure

The Bill proposes limiting the Fee Disclosure Statement requirement to only those investments entered into after 1 July 2013.

5.4 Analysis of the Proposal: Back to the Pre-FOFA position

Removing the annual fee disclosure requirements for pre-1 July 2013 investments is denying the first benefits of the FOFA reforms for existing consumer investors.

Although the FOFA reforms only came into effect on 1 July 2013, advisers and planners must still report annually on their fees and commissions to their clients even though the original advice and investment happened years before then. Combined with the 'opt-in' requirement this puts investors in a good position to monitor the on-going cost of their investment advice and service.

Removing the "opt-in" requirement and that for annual fee disclosure statements, will place thousands of existing consumer investors in the same position they were pre-FOFA. Their disclosure of ongoing fees will depend on the marketing needs of their planners and on their own vigilance.

This begs the question:

" Why don't advisers and planners want their clients to know, each year, what they are making in commissions and fees on their investments?"

It would not be difficult provide such reports and it is information the advisers and planners already have. On a cost/benefit basis, this proposal presents a major consumer detriment with little saving in administration costs.

6. Widening the Grandfathering Exemptions from the Conflicted Remuneration Ban

6.1 General Commentary

Conflicted remuneration was always conflicted. Its potentially pernicious influence is now acknowledged by both sides of politics, by the regulators and by industry stakeholders. It is now banned for personal advice. It was, however, always a problem. This problem did not suddenly arise on 1 July 2013.

The concession to industry to 'grandfather' commissions and other benefits from product issuers entered into before the FOFA commencement date was just that, a major concession. To further extend it to the situations canvassed in the Bill, is to compromise the integrity of the FOFA reforms. It will, of course, result in windfall gains for advisers and planners who will be allowed to retain (or be remunerated for assigning) on-going commissions and fees from existing investments. This will impact on the returns to existing consumer investors costing them thousands of dollars.

6.2 The Government's Proposal: Widen the Concession

Put simply, the government proposes, by regulations, to extend the exemption from the conflicted remuneration ban to arrangements that affect clients who have investments existing up until 1 July 2014, as long as the arrangements were entered into prior to 1 July 2013.

Certain events, such as:

- the sale of the adviser's business;
- the switching of a consumer's superannuation product from the growth phase to the pension phase; or
- the switching of an authorised representative to a licensee and vice versa;

may have been interpreted as cutting off the grandfathered rights to otherwise banned conflicted remuneration.

The effect of the new Regulations is summarised in the Explanatory Statement for the Regulations as follows:

> *Item 19 – inserts a new sub-regulation 7.7A.16A(5A) to clarify that when a business is sold (and that business is acting in the capacity of a platform operator), the rights to the grandfathered benefits are transferred to the purchaser, who can then receive the ongoing benefit. The purchaser may therefore acquire the same rights to the grandfathered benefits that the seller held prior to the sale taking place.*
>
> *Item 20 – inserts a new sub-regulation 7.7A.16B(4A) which has the same effect as Item 19, except that this sub-regulation refers to the sale of businesses which are not acting in the capacity of a platform operator.*

Item 21 – inserts a sub-regulation 7.7A.16B(5A) to provide that when a retail client elects to switch from the growth phase to the pension phase within the same superannuation interest, this will not be treated as the acquisition of a new financial product for the purposes of regulation 7.7A.16B. This will allow grandfathered benefits to continue to accrue where the client held the superannuation interests prior to 1 July 2014 and made the election after this date.

Items 22 and 23 – amend existing regulation 7.7A.16F to provide that the requirement in paragraph 7.7A.16F(b) does not apply when:

- *an authorised representative of one licensee becomes an authorised representative of another licensee after the application day of the ban on conflicted remuneration;*
- *a representative (for example, an employee) of a financial services licensee becomes an authorised representative of the same licensee.*

6.3 The effect of the proposal: It will cost consumers

Industry argues that failing to grant these further concessions will undermine the value of the adviser's businesses in a discriminatory way compared to those advisers who don't sell or restructure or for whose clients are not moving from the accumulation to the pension stage of their superannuation products.

The answer is that this 'value' rests on conflicted remuneration. If such remuneration is now understood to be wrong in principle then allowing licence holders to profit further from its accumulation, sometimes for years, after the FOFA ban is difficult to defend.

Product issuers did not absorb the commissions they paid (and in these case will continue to pay) to advisers and commissions. These "costs of doing business" reduce the returns on investment products to consumer investors. They will continue to do so for the already exempted grandfathered investments. This proposal will extend the life of that already unsatisfactory situation even further.

The number of consumer investors affected by these proposals, however, is relatively small and will, of course, over time reduce. This is why they can be assessed as being a minor consumer detriment.

7. Explicitly allowing for the provision of 'scaled advice.'

7.1 The Situation Pre-FOFA: Almost All or nothing

Prior to the FOFA reforms, it was not always cost efficient for a financial planner or adviser to respond effectively to a client who was only asking for advice about a single product. Any "personal advice", even if only in relation to a particular product or class of products, had to be recorded in a SOA. The inquiries which the adviser had to make about the client's circumstances, the objectives, their overall financial position and the suitability of the product recommended were the same regardless of whether only one class of product was under discussion or the entire financial plan for the consumer investor.

The statutory and regulatory requirements for an SOA were the same for a "limited advice" situation as for any other. As discussed above, these were many and the documents were frequently voluminous. Remuneration, regardless of source, whether conflicted or not, sufficient to cover the cost of the interviews, documentation and administration of such advices, was often difficult to acquire. It was certainly difficult to explain to the consumer investor.

So, as a result, planners and advisers either did not offer such a limited advice service or when they did, it seemed overpriced for consumers.

7.2 FOFA: Provided for Scaled (or limited) Advice

The 'best interest' duty provisions introduced by the FOFA reforms, expressly provided for scaled advice. The Statutory Notes to section 961B(2) of the Act say:

> *The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the* ***subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.***

As ASIC pointed out to licence holders in its Regulatory Guide 244 *Giving Information, General Advice and Scaled Advice* : "You can adjust the level of inquiries to reflect the nature of the advice sought."[45]

What FOFA did not do, however, is:

- remove the requirement for the provision of FSGs, PDS and SOAs when they would normally be required. AS ASIC points out in RG244, however, the SOA in a scaled advice situation can itself be scaled down to suit the level of advice.
- exempt scaled advice from the "best interests" duty.

The FOFA reforms provided for 'scaled advice' but expressly preserved consumer protection.

[45] ASIC RG244.71

7.3 The Government's Proposal: Make Scaled advice "easier" for advisers

This submission has already dealt with the proposal to remove the "catch all" section in 916B(2)(g) and 916E. These, according to the government are reforms that will more "explicitly" allow for scaled advice by reducing the burden on advisers and planners in the more limited advice situations. The reduction in consumer protection posed by these proposals has already been discussed above. It is not less so for the scaled advice situation.

The Bill also proposes adding after s916B(4), the following:

> Client seeks scaled advice
>
> (4A) To avoid doubt, nothing in subsection (2) prevents a client from agreeing the subject matter of the advice sought by the client with 23 the provider.

7.3 Analysis of the Government's Proposal: Less consumer protection

The reduction in consumer protection overall by the weakening of the "best interests" test has been discussed above. In the context of scaled advice, it has some particularly disturbing characteristics.

The combined effect of 916B(2)(g) (the 'catch all') and 9I6E ('the other step') was that even in the scaled advice situation where the client had only asked about specific products, the adviser would have to consider other products and strategies if they were in the client's best interest.

As the Financial Planning Association has said:

> *… even if substantive recommendations about these different products and strategies were not made, the financial planner or adviser was obliged to consider whether the scale of advice was suitable to the client.*[46]

Taking these away, will reduce dramatically the incentive for a planner to consider the entirety of a consumer's position when the consumer investor, in their ignorance of the market and financial matters, has expressly asked for "limited" or scaled advice thinking it will cost them less. It may do so but only the short term.

These amendments proposed in the Bill have the potential to convert financial advisers and planners back into the product salesman some of them were in the pre-FOFA days of conflicted remuneration. They represent a potential **major consumer detriment**.

[46] FPA n 38 above p 7