FINANCIAL PLANNING ASSOCIATION *of* AUSTRALIA

Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

FPA SUBMISSION | SENATE ECONOMICS LEGISLATION COMMITTEE | DATE: 15.09.2014

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

15th September 2014

Dear Sir / Madam

RE: Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide comments on the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*. The amendments to this Bill, including changes to the content of Statements of Advice, have significant implications for financial planners.

Our submission reflects some of the concerns raised in our previous submission to the Senate Economics Legislation Committee on this Bill. However, we support many of the Government's amendments to the previous Bill. In particular, we support the definition of 'commissions' in Schedule 29 of the Bill, as well as changes to the Fee Disclosure Statement (FDS) regime in Schedules 20A and 20B.

The FPA is supportive of measures to improve the quality of disclosure to clients, and which inform clients of the statutory rights and obligations which influence the relationship between them and their financial planner. However, the measures as currently drafted do not address the core issues regarding the effectiveness of disclosure, and should be better adapted to the existing disclosure obligations in Chapter 7 of the Corporations Act. Furthermore, the terms 'further advice' and 'varied advice' have not been explained with sufficient clarity in order to avoid unintended consequences.

We thank you again for the opportunity to consult on this Bill, and we welcome further opportunities to consult with the Committee on this Bill. If you have any questions, please contact me

Yours sincerely,

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia

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PROPOSED FOFA AMENDMENTS

FPA submission to:

The Senate Economics Legislation Committee

15 September 2014

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INTRODUCTION

This submission forms the latest of a series of considered contributions to the formulation of sensible FOFA regulation on behalf of the Australian public. The Financial Planning Association of Australia (FPA)[1] is committed wholeheartedly to the core principle of placing the client's best interest above all else.

We are encouraged that the Government has addressed many of the concerns we have raised in previous submissions. This Bill incorporates many changes, such as a statutory definition of 'commissions', which will improve the culture of financial planning and financial services in Australia while offering certainty to the financial planning profession on their obligations.

This Bill includes amendments which passed the House of Representatives on 28 August 2014. The amendments include changes to the obligation to give retail clients a Statement of Advice (SOA), as well as the prescribed content of SOAs, in sections 946A, 947B, and 974C of the Corporations Act 2001 (Cth). The Bill, if passed, will introduce additional disclosure requirements for SOAs regarding the financial advice provider's obligations to the client and additional fee disclosure. It will also require SOAs to be signed by the advice provider and the client, and further instructions from clients to be acknowledged by the advice provider.

The FPA supports the broad policy intent of these additional requirements. However, there are fundamental problems with relying on disclosure-based regulatory measures as government policy. This is particularly true in the financial services sector, where the complexity of the products and the legal/regulatory environment can obscure and obstruct the policy intention of disclosure-based regulatory measures.

We would expect ASIC to provide clear guidance on how to present the new disclosure requirements, as well as the measures requiring the signing and acknowledgment of SOAs and further instructions, in order to prevent this regulatory measure from devolving into burdensome red tape.

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[1] The Financial Planning Association (FPA) represents more than 10,000 members and affiliates of whom 7,500 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- We banned commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FOFA.
- We have an independent conduct review panel, chaired by Dr June Smith, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

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STATEMENTS OF ADVICE

It is important that clients of financial planners understand their rights under the Corporations Act. The FPA supports efforts to inform and empower consumers of financial advice. Our Code of Professional Practice emphasises the client's understanding of the financial advice process and the advice which the client eventually receives.

However, we are concerned about the practical aspects of the Government's approach. The new fee disclosure obligations are duplicative with existing obligations in the Act. Item 1B of the Bill states:

> (cd) information about any fees that have been or may be charged to the client in relation to the advice by any of the following:
>
> (i) the providing entity;
> (ii) a related body corporate of the providing entity;
> (iii) a director or employee of the providing entity or a related body corporate;
> (iv) an associate of any of the above;
> (v) any other person in relation to whom the regulations require the information to be provided;

We note the provisions are very similar to the existing subsections 947B(2)(d) and (e):

> (d) information about any remuneration (including commission) or other benefits that any of the following is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice:
>
> (i) the providing entity;
> (ii) a related body corporate of the providing entity;
> (iii) a director or employee of the providing entity or a related body corporate;
> (iv) an associate of any of the above;
> (v) any other person in relation to whom the regulations require the information to be provided; and
>
> (e) information about:
>
> (i) any other interests, whether pecuniary or not and whether direct or indirect, of the providing entity or of any associate of the providing entity; and
> (ii) any associations or relationships between the providing entity or any associate of the providing entity and the issuers of any financial products;
>
> that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice;

Furthermore, fee disclosures are required in Financial Services Guides as well as the new FDS regime for ongoing advice relationships. The FPA recommends that the Committee seeks clarity on how these obligations should be met in a way that is not duplicative and is meaningful to consumers of personal financial advice.

We are also concerned about the introduction of the terms "further advice" or "varied advice" into the Act without a legislative framework to support them. The Revised Explanatory Memorandum to the Bill states:

> The instructions for further or varied advice can be documented in writing and signed by the client either before or after the advice is given. This allows for flexibility in time-critical situations. For example, if the stock market crashes and a client seeks time-critical further advice that they subsequently want actioned immediately, the instructions for further or varied advice can be documented in writing and signed by the client after the advice has been given.[2]

Beyond this statement, there is no guidance on which circumstances that the proposed 946A(2D)-(2G) and 947B(2)(fb) would apply to. There may even be some risk to consumers in adopting this provision, as this provision could provide a safe harbour to revise initial advice by including advice of a very limited scale which recommends adopting particular financial products. The FPA recommends that the Committee seek guidance on whether this new disclosure obligation reflects existing practice to update the advice as the circumstances, needs, and objectives of the client change, or if it applies in other cases as well.

There is also some concern about whether the signing and acknowledgement of SOAs and instructions for further advice are compatible with existing practice, or require something further. In particular, securing an effective and unambiguous legislative arrangement for the electronic delivery of SOAs and client instructions is critical to improving affordability and access to financial advice. The FPA recommends that the Committee require further clarification of Items 1A and 1B with respect to what constitutes a signature and an acknowledgement in electronic form.

Lastly, we have frequently raised our concerns about the existing disclosure burden for advice providers and for clients of financial planners. Disclosure-based regulatory regimes have come under intense scrutiny through the Financial System Inquiry and elsewhere. It is worthwhile to have clients aware of the advice provider's responsibilities under FOFA, as well as the rights of the client, but this measure must be implemented in a client-focused manner to be effective.

[2] Revised Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 (Cth), p 45

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THE BEST INTERESTS DUTY

The FPA believes that acting in the best interests of the client is a hallmark of professionalism. For the most part, the existing statutory 'best interests duty,' as well as related statutory duties in the Corporations Act,[3] reflect the degree of professionalism we expect as a minimum standard for financial planners and as required under our Code of Professional Practice.

However, the FPA is concerned that the 'catch-all' provisions of the best interests duty (subsection 961B(2)(g) and section 961E[4]) set an unclear and unrealistic expectation for even professional financial planners. We argue that;

- the words in the legislation "taken any other step" (subsection 961B(2)(g)) and "take a step" (section 961E) form an open-ended requirement that is practically impossible to satisfy;
- it is not clear what is intended by taking "any other step" that is not already covered in the other provisions of section 961B;
- the consumer protection offered by the catch-all is less effective than the general law as it can only be realised through litigation by ASIC, and;
- the standard of conduct intended by the 'catch-all' provision cannot be mandated by legislation or originate from the judiciary, but must emerge from a confluence of hard and soft regulation, legislation and self-regulation, and innovation.

This lack of clarity opens significant litigation risks for financial planners that are only tenuously connected to a consumer protection benefit. Removing these provisions does not water down the consumer protections of the FOFA regime. Financial advice must still be in the client's best interest (section 961B), <u>appropriate</u> for the client (section 961G), and the financial planner must still <u>prioritise the client's interests</u> (section 961J) ahead of their own.

Further, subsection 961B(2)(f) requires professional judgement as one of the steps of the best interest duty. This was not a requirement before FoFA and requires the financial planner to base all judgements they make in advising the client on the client's relevant circumstances. This includes judgement about the scope of the advice, the enquiries they make, the strategies and products they recommend.

Recommendation:

The FPA recommends that the Committee supports items 10 and 14 of Schedule 1 of the Bill which repeal the best interest 'catch-all' provisions.

[3] E.g. the duty to prioritise the client's interests ahead of one's own (section 961J), and the duty to give advice which is appropriate for the client's needs, objectives, and situation (section 961G).
[4] All references to legislation refer to the *Corporations Act 2001* unless otherwise specified.

SCALED ADVICE

The FPA supports efforts to improve clarity for financial planners who wish to provide scaled advice. However, we believe that additional changes to section 961B are necessary to maintain consumer protection and support the best interest duty.

The key policy objectives in providing a legislative framework for scaled advice are:

- creating certainty for advice providers regarding the matters which may reasonably be excluded from 'fact finds', financial strategy, and product recommendations;
- protecting consumers from unethical business practices, such as negotiating an inappropriate or suboptimal scope for financial advice, and;
- facilitating more efficient and targeted forms of personal financial advice for retail clients, in order to improve access and engagement with our financial system.

We believe that items 11 and 13 of Schedule 1 of the Bill do address these policy objectives. Item 11 amends the note to subsection 961B(2) by clarifying that there is a 'reasonableness' test in order to exclude circumstances from the fact-find process. Item 13 states that the scale of the advice is to be negotiated and agreed upon between the client and the advice provider. These amendments create certainty for financial planners, and have the ability to facilitate scaled advice.

However, we believe that items 7 and 8 are unlikely to have any effect. These items repeal subsection 961B(2)(a), and create subsection 961B(2)(ba) which is materially identical to subsection 961B(2)(a). The intent of these amendments is to clarify that a "full fact-find" is not required for all personal advice, and the relevant circumstances which the advice provider must consider are defined by the subject matter of the advice.[5] We believe that the current subsection 961B(2)(a) does not require a "full fact-find" for all personal advice, and the clarifications to scaled advice make this clear. Finally, the "order" of the steps in subsection 961B(2) provides guidance, but does not dictate how advice providers should satisfy the best interests duty. If anything, the amendments may encourage a lower standard of investigation into the client's relevant circumstances.

Recommendation:

The FPA recommends that the Committee support items 11 and 13 of the Bill.

The FPA recommends that the Committee reject items 7 and 8 of the Bill.

[5] Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 [1.33]-[1.40]

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GENERAL ADVICE

The FPA acknowledges and welcomes that the Government has made amendments to the Exposure Draft of the Bill which explicitly define commissions in the Corporations Act, as well as retaining the existing ban on commissions. We have strongly opposed the reintroduction of commissions into financial advice in any form.

We do acknowledge that there have also been unintended consequences of the FOFA reforms for general advice providers. On a broad interpretation of section 963A and the term 'conflicted remuneration', the ordinary remuneration for general advice providers could be considered conflicted remuneration, even where that advice is limited to basic information about a product. Providing product information to customers does serve a purpose in educating and engaging consumers, especially if that information helps consumers to understand the value of seeking advice.

As the FOFA reforms were intended to protect consumers from unethical sales practices, the existing legislation creates unintended regulatory overreach. We believe that the current Bill reflects a more precise distinction between commission payments and ordinary forms of remuneration which pose a more manageable risk of conflicts of interest.

Other measures should be implemented to ensure that general advice does not continue to pose risks to consumers. Our second-round submission to the Financial System Inquiry recommended that the government redefine 'general advice' as 'general information' or 'financial product information in order to address the risk that consumers will perceive general advice as relevant to their personal circumstances (see Appendix A – General Advice). We recommend that the Committee support this measure in their Report. We also recommend that the terms 'financial planner' and 'financial adviser' be defined in the Corporations Act, and restricted to those who are providing personal financial advice on Tier 1 financial products (see Appendix B – Enshrinement of the term 'financial planner/adviser')

Recommendations:

- General advice should be re-termed "general information", "factual information" or "financial product information".
- The new term should be regulated with a warning similar to the general advice warning. This warning should make it clear that the information is not financial advice; it is information about a financial product or a class of financial products.
- Licensing and all the other forms of regulation which currently apply to general advice should apply to the new term.
- The term 'financial planner/adviser' should be restricted to those who are members of a recognised professional body.

OPT-IN AND FEE DISCLOSURE STATEMENTS

The FPA supports the repeal of the Opt-in requirement, as well as the removal of retrospectivity from the FDS regime. We have consistently argued that these two measures have undermined the effectiveness of FOFA. Our view is that they detract from the policy objectives of FOFA by adding regulatory burdens with no clear connection to raising the quality or improving the culture of financial advice in Australia.

While we agree with the policy objective of client engagement, we believe that Opt-in creates an artificial, documentary form of compliance. It also undermines the existing authentic and organic engagement process conducted by professional financial planners, which allows clients to Opt-out at any time. Furthermore, as Opt-in only applies to new clients who sign up to ongoing fee arrangements created from 1 July 2013, clients who pay grandfathered trailing commissions will be unaffected by the Opt-in regime. Lastly, when a client allows an ongoing fee arrangement to lapse under Opt-in, their investments remain in place but unmanaged. This position exposes the lapsed client to significant risk.

The FPA supports prospective FDSs, however we believe that applying the regime retrospectively is a limited, formalistic procedure that does not enhance the adviser-client relationship. Further, the policy intent of the FDS requirement was to improve the disclosure of commissions and assist in phasing out trail commissions. However, commissions are <u>not required</u> to be disclosed in a FDS.

The Explanatory Memorandum notes that an ongoing fee paid by a third party to an AFS licensee or a representative (which would include a commission) will generally not constitute an ongoing fee for the purposes of subsections 962A(1)(c) and 962A(2)(c).[6] ASIC's guidance on the FDS regime states that:

> "*We therefore consider that commissions generally do not need to be disclosed in the FDS, on the basis that they are paid under a commercial arrangement between a product issuer or platform operator and an AFS licensee or a Representative.*"[7]

The retrospective application of the FDS law creates a significant cost for industry and does not deal with the original policy intent of commissions. As this was not previously required, there were no systems in place to record and collect this data at the time the services were provided to the clients prior to the new law commencing on 1 July 2013.

By limiting FDS requirements to clients going forward, the amendments offer a more efficient and effective transition to FOFA while producing the intended consumer benefit of transparency. Accordingly, the FPA supports Items 21 and 22 of Schedule 1 of the Bill which repeal the Opt-in requirement and retrospective fee disclosure statement requirement. However, we are concerned that the wording of section 1531D in Division 2 of the Bill may circumvent the intended starting date for the FDS regime (1 July 2013) by resetting the date to the commencement day of the current Bill. This

[6] Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 at [1.13]
[7] ASIC, Regulatory Guide 245: Fee Disclosure Statements (January 2013), at [38]

would effectively create a period of uncertainty between the original FDS starting date of 1 July 2013 and the commencement of the Bill, potentially making the FDS requirement apply retrospectively during this period. The FPA recommends that the starting date for the FDS regime remain as intended by the original FOFA reforms – that is 1 July 2013.

We also recognise that the Government has acknowledged our concerns with the previous 30 day window for preparing an FDS, and has extended that time period to 60 days in the current Bill. We recommend that the Committee support this measure.

Recommendation:

The FPA recommends;

- that the Committee supports Items 21 and 22 of Schedule 1 of the Bill which repeal the Opt-in requirement and retrospective fee disclosure statement requirement, and;
- that the Committee supports Items 20A and 20B of Schedule 1 of the Bill which extend the reporting period for FDSs.

TRANSACTION-ONLY SERVICES

In our submission to Treasury regarding the Exposure Draft of this Bill, the FPA noted several problems with allowing commissions in connection with transaction-only services. To a significant extent, the current Bill mitigates these risks by specifying that only employees (and hence not authorised representatives of AFSL holders) may receive conflicted benefits in connection with transaction-only services. Nonetheless, we believe that allowing commissions as a conflicted benefit for transaction-only services creates perverse incentives for individuals and firms, and therefore the Bill should ban commissions for these services as well.

We also remain concerned that complex financial products can be sold on a non-advised basis. International developments indicate a shift away from permitting complex products to be distributed independently of financial advice or a suitability assessment for the client.[8]

Recommendations:

The FPA recommends that commissions remain banned with respect to transaction-only services (and superannuation and investment advice generally) where connected to complex financial products.

[8] E.g. IOSCO, 'Suitability Requirements With Respect To the Distribution of Complex Financial Products' (January 2013); ESMA, 'Opinion: MiFID practices for firms selling complex products' (February 2014).

APPENDIX A – GENERAL ADVICE

The FPA's first round submission to the FSI Panel observed that there is significant confusion in the market, and within industry, media, Government and consumers about the definitions and roles of financial planners/advisers, and those that sell financial products. Some incorrectly mistake the use of the word 'advice' to be a standard definition when in fact there is a significant legal and technical difference between 'general' and 'personal' advice.

Defining financial product advice on the basis of whether or not the advice makes a personal recommendation is complex and ignores the realities of how individuals make decisions. This risk is confirmed by ASIC's *Report 384 – Regulating Complex Products*, where the Report states:

> "*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.*"[9]

Framing general advice as financial advice plays into the behavioural aspects of financial decision-making by giving the impression that the advice has a reasonable basis or is appropriate for the client, and thereby exposes retail investors to decisions made under uncertainty about the regulatory framework for that advice.

As with many other problems in the Australian financial system, our reliance on a disclosure-based regulatory approach has contributed to this confusion. While a general advice warning is required to be issued when providing general advice, it is the context of the advice which is more influential on many consumers than the warning.

According to ASIC licensing data, there are 50,276 Australian Financial Services License holders and 51,477 authorised representatives of AFSL holders who are licensed to provide 'financial product advice' as defined under the Corporations Act. Such people might work as bank tellers, product provider call centre staff, sales people, or fully-fledged financial planners all providing different types of advice services to consumers depending on their training, competency, and authorisation. However, from a consumer perspective there is minimal understanding in the different roles and restrictions placed on the different providers, as well as the limitations of the advice that consumers may be provided.

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

A major obstacle to effective separation of financial advice and product information is the wide variety of conduct that is presently described by 'general advice'. It is difficult to imagine a uniform set of regulations which can effectively regulate all forms of information about financial products within every single context these discussions or communications may arise. Part of the problem is revealed in the choice between describing general advice as 'product information' or 'sales information'. Both of these terms are inadequate to describe and apply to the context of each instance where financial product information that is not a recommendation based on personal circumstances is provided.

For the purposes of protecting consumers from misrepresentations about the suitability of product information for their circumstances (whether those misrepresentations are overt or contextual), a clear separation between financial advice and product information is required. In the long term, providing meaningful regulatory categories for different forms of financial product information is a very difficult but necessary project. These categories are required to appropriately and effectively regulate different communication channels through which consumers access information about financial products.

Recommendation 9:
The FSI Final Report should recommend re-naming general advice as 'product or general information', and also recommend that the terms 'financial advice' and 'financial product advice' should only apply to personal advice as defined by the Corporations Act.

APPENDIX B – ENSHRINEMENT OF THE TERM 'FINANCIAL PLANNER/ADVISER'

To strengthen consumer protection and to continue the journey towards creating a true profession, the law must restrict the term financial planner/adviser to only those that have the highest level of education, competency, ethics, and standards, and are a member of a regulator-approved professional body.

Leaving the use of the term financial planner/adviser unregulated is a significant gap in consumer protection. It leaves trusting consumers open to influence by unlicensed and unqualified individuals who misrepresent themselves as financial planners.

During the Parliamentary Joint Committee (PJC) Inquiry into the collapse of Storm Financial committee acknowledged in their report [5.87]2:

> *…legitimate concerns about the varying competence of a broad range of people able to operate under the same 'financial adviser' or 'financial planner' banner. The licensing system does not currently provide a distinction between advisers on the basis of their qualifications, which is unhelpful for consumers when choosing a financial adviser.*

There is a high level of confusion in the market, and within industry, media, Government and consumers, about who is qualified to provide financial advice in Australia. The current market for financial advice can include financial planners, financial advisers, financial product salespersons, unlicensed rogue operators, and those who misrepresent their products and services as financial advice and/or financial products. Some incorrectly represent themselves to consumers as financial planners without the appropriate, training, licensing, and professional standing and competency required. This significantly erodes consumer protection. The lack of constraint on individuals calling themselves financial planners puts consumers at risk of receiving poor advice from incompetent providers and creates confusion for consumers.

The term financial planner is also increasingly being used in marketing and promotional material by persons who provide non-traditional ancillary services, such as realtors, stockbrokers, life insurance agents or brokers, mortgage brokers, property brokers, sales agents of various investment vehicles, accountants, and unlicensed individuals.

The current mis-use of the terms financial planner and financial adviser impacts on consumer trust and confidence in the profession, as a result of the actions of incompetent providers who should not have the legal capacity to call themselves financial planners.

This position is supported by an article in the Canberra Law Review (2011)[10]:

[10] Marcus Ap,'The Future of Financial Advice Reforms: Restoring Public Trust and Confidence in Financial Advisers – An Unfinished Puzzle'. (2011) Canberra Law Review Vol. 10, Issue 3, pp 192-193

> *Trust and confidence in a professional industry is built upon the belief that the professionals working in that industry have special training and knowledge, high standards of accountability and a belief that advice given is in the best interest of the client seeking expert knowledge. Without adequate training and specialist knowledge, it is difficult to see how any of the previously mentioned factors can be fulfilled, as good advice cannot be given by an adviser whom has not been properly trained and lacks specialist knowledge. In order to restore trust and confidence in the financial advice industry, these issues must be addressed.*
>
> *Furthermore, a closely related matter to this issue that is yet to be implemented is the restriction of the use of the term 'financial adviser' and 'financial planner' to people that have membership to the appropriate professional standards board. Until these issues have been addressed, there will remain significant deficiencies in the implementation of the Ripoll Inquiry recommendations, which will hinder progress in restoring consumer trust and confidence in the financial advice industry.*

Australians deserve the best possible advice from the most qualified practitioners, and these practitioners should be bound by a professional framework that goes beyond the law. This framework should require adherence to standards of conduct, ethics and education which are specifically tailored to the provision of quality financial planning advice.

In restricting the use of the term financial planner/adviser, the FPA recommends that the criteria for using the terms financial planner and financial adviser should be linked to membership of a recognised professional body.

Recommendation: 11
The FSI panel should recommend the term financial planner/adviser is restricted under the Corporations Act to those individuals who are members of a recognised professional body.