CHARTERED SECRETARIES AUSTRALIA

Leaders in governance

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Dr Richard Grant
Acting Secretary
Senate Economics Committees, SG.64
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By email: economics.sen@aph.gov.au

Dear Dr Grant

Senate inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011

Chartered Secretaries Australia (CSA) is the independent leader in governance and risk management. As the peak professional body in Australia delivering authoritative accredited education and the most practical training and information in the field, CSA is focused on improving organisational performance and transparency.

Our Members are all involved in governance, corporate administration and compliance with the *Corporations Act 2001* (the Act). Our Members work in both public listed and public unlisted companies, as well as in private companies. We have drawn on their experience in providing our submission to the Senate Economics Committees' Inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011. However, we do not comment on the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

General comments

The collapse of financial service providers such as Opes Prime, Trio and Storm Financial thrust the financial services industry into the spotlight. The subsequent Parliamentary Joint Committee on Corporations and Financial Services' *Inquiry into Financial Products and Services in Australia* Report (the report), released on 23 November 2009, provided some direction for reform of the sector.

The recommendations and direction of the report informed the first stage of the Future of Financial Advice (FOFA) reform process and CSA commends the FOFA reforms as an excellent initiative which, in principle, aims to protect consumers from disingenuous advisers in the financial products arena. CSA notes that the reform to the financial planning sector is structured to improve the 'quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interest of the adviser with the client and reduce conflicts of interest'.[1]

[1] Corporations Amendment (Future of Financial Advice) Bill 2011, Commonwealth of Australia, Explanatory Memorandum, p 3

CSA does, however, hold concerns about the process of reform which has been envisaged by the exposure draft. The Australian financial services sector comprises a diverse range of organisations and sub-sectors providing various financial products and services. By implication, amendments to Chapter 7 of the Act affect a wide range of organisations involved in the provision of financial services. With respect to the current exposure draft, therefore, CSA suggests that the impact of the reforms may spread further than the intention of the drafting.

CSA notes that, so far, there has been a piecemeal approach to the current reform making it difficult to assess the overall likely impact on the sector and consumers. For example, the outcome of the consultation on the FOFA options paper, entitled *Wholesale and Retails Clients Future of Financial Advice*, which closed on 25 February 2011, has not been made public. It is assumed that the distinction between retail and wholesale consumers' remains but it is unclear whether the definitions will change. This demonstrates the difficulty of reviewing exposure draft and explanatory memorandum of the Corporations Amendment (Future of Financial Advice) Bill 2011 in isolation, where the context is still somewhat uncertain. A further example is the reference in the explanatory memorandum to the second tranche of reforms targeting a 'ban on conflicted remuneration, including commissions, volume payments and soft-dollar benefits', which has been released for public comment but whose consultation outcome is also as yet unknown. As the exposure draft deals with aspects of advisers' fees, the issue of other benefits and definitions should also have been included to understand the overall impact.

CSA further notes the Australian Securities and Investments Commission (ASIC) recently closed submissions on its consultation paper 164 (CP 164) entitled, *Additional guidance on how to scale advice* (CP 164) which 'gives guidance about how to scale personal financial product advice to retail clients'. CSA believes that there may be unintended consequences arising from the interaction of the proposed exposure draft and other information available to the public from the regulator. For example, there may be unintended consequences arising from the interaction of the 'best interests' test in the proposed s 961C of the Act and ASIC guidance based on consultation paper CP 164.

Best interest obligations

CSA strongly supports the introduction of the 'best interest' obligations as a statutory requirement within Chapter 7 of the Act. It is self evident that this kind of reform places the consumer at the centre of the relationship with their adviser and ensures that a transparent advising process ensues.

CSA is, however, concerned that the provisions of the proposed s 961C are too prescriptive in nature. The width of advice provided with respect to financial services means that, while the exposure draft relates well to the financial planning part of the industry, there are other advisers and products that will be disproportionately affected. CSA notes that the ASIC CP 164 on *Additional guidance on how to scale advice* discusses the options associated with scaled advice in the provision of financial products. CSA believes that the prescriptive nature of the exposure draft effectively contradicts the implementation of scaled advice because the provisions allow no flexibility for differing financial products.

While some relief has been included for an adviser providing advice about basic banking products, all other financial products, including other well understood products such as general insurance, will require compliance with all subsections of 961C. CSA is aware that a considerable proportion of general insurance and risk life insurance is distributed through tied agents and the direct selling areas of the insurers. The practicalities of a Customer Service Representative (CSR) obtaining and interpreting that additional advice on another subject matter would appear to exceed the normal business practices of this style of product distribution.

There are also further practical challenges to meeting the requirements of the proposed s 961G(4) which provide that advice must be supplied to the client in writing; and the adviser cannot recommend a product where the adviser is working in an insurer call centre or tied agency and they only have limited product (possibly from one product issuer) available.

Given the civil penalty provisions and the prescriptive nature of s 961, CSA is concerned that, rather than facilitating the provision of greater advice to retail customers, the legislation may reduce the provision of advice about other banking and insurance products, that is, those products that are most commonly dealt with by employees and agents of the ADI or insurer, rather than a financial planner.

In light of the provision that an applicant has six years within which to bring an action, it is likely that the imposition of this section will be particularly burdensome. An adviser who provides personal advice about a financial product under s 961C(3) may well comply with s 961(2)(a),(b)&(c) but not keep a written record of that advice. For a client to then commence an action some six years later places a very heavy burden of proof of the adviser, who, according to the nature of these provisions, will need to provide evidence that they have complied with the client's best interests.

CSA recommends that the length of the statutory timeframe for bringing an action should be variable depending on the complexity of the advice and products involved or otherwise clarified to protect simple financial products, including basic banking and general insurance products, where the adviser would be participating in numerous transactions on a daily basis. CSA notes that the reform is not specifically targeted at simple financial products, yet the compliance regime for the provision of advice about these products is likely to increase for many entities.

CSA notes that the various state-based Limitation Acts, which set out the limitation periods for bringing actions in different contexts, contain periods of varying length. The NSW Act, for example, imposes limitation periods from one year to 12 years depending on the circumstances. A variable scale in the context of financial advice would not be out of place.

Charging ongoing fees to clients

CSA supports the need for better disclosure of trailing commissions or commissions derived from sales. There is a well established culture of financial advisers across the industry receiving commissions for selling various types of products to clients. While legislation cannot stop clients from losing money based on poor investment decisions, the move towards transparency provides clients with a better understanding of financial products and relative costs and risks involved.

However, the idea of disclosure is only considered in light of legislative provisions rather than through existing established documentation. The current s 942B(2)(e) of the Act requires that a financial services licensee who is required to provide a Financial Services Guide must disclose

> information about the remuneration (including commission) or other benefits that any of the following is to receive in respect of, or that is attributable to, the provision of any of the authorised services

This provision applies to the entity, director, employee, or any person associated with of any of the aforementioned people. CSA submits that the proposed reform is clearly an overlap of disclosure obligations. The exposure draft and the accompanying explanatory memorandum do not adequately address the overlap, nor do they account for any potential consequences which might arise as a result of the insertion of Division 3 of the exposure draft.

As an example, CSA refers to the use of the term 'renewal'. This is a term currently used in the insurance industry in relation to the renewal of an insurance policy, and certain legislative requirements must be met by the insurer at least 14 days before the policy expiry date. However, part of that arrangement may be that the adviser receives a commission for the renewal business. The commission is embedded in the premium. It would appear that the proposed s 962A(b) would apply in that the commission is 'reasonably characterised as relating to the advice when the arrangement was entered into'. This requires clarification.

For general insurance, if this is not the case, then there will be a disconnect between the requirements of an insurance adviser to provide a fee renewal and disclosure notice 30 days before the anniversary date and the provision of the insurance policy renewal. The adviser is normally reliant on the insurer to provide the proposed renewal terms, and the renewal documents may be forwarded directly to the insured. The adviser may not be able to provide the required fee information within the required period and CSA believes that greater clarity is required relating to insurance renewal business to allow time for amendments to systems and processes as this potential impact has not been evident in prior discussions about these reforms.

CSA also notes the shift in policy exemplified by s 962K which states that, where a client does not notify that they wish to renew an ongoing fee arrangement with an adviser, the arrangement terminates 30 days after the end of the renewal period. CSA highlights that the application of this provision is potentially confusing for both clients and advisers. The obligation placed on the client is contrary to usual practice, and the wording of the section fails to distinguish between ongoing relationships or new relationships which are established. Furthermore, the provision does not account for any process involved in the termination of the fee arrangement and the timing of the completion of that process.

CSA is also aware that for many financial products, the manufacturers of that product have until now relied on there being a financial adviser between them and the investor. Some entities may not hold an appropriate AFS licence authority to deal directly with retail clients. Clarity is required about how these situations are to be dealt with by the entity that is the product issuer.

This is compounded by the potential for civil penalties to apply to advisers who do not abide by the proposed s 962K. For example, where a consumer has changed his or her address and does not notify the adviser, what relief is envisaged while the adviser seeks to locate their client? CSA notes that s 962K does not provide a statutory defence for an adviser who demonstrates compliance with Division 3 but makes an inadvertent mistake. CSA believes that a statutory due diligence defence should also be enacted thereby ensuring that punishment is not unfairly imposed on an adviser who has otherwise complied with the provisions, but has made an honest mistake or miscommunication.

Enhancing ASIC's licensing and banning powers

CSA agrees with the proposal to enhance ASIC's licensing and banning powers and does not wish to comment further on this part of the exposure draft and explanatory memorandum.

Conclusion

CSA strongly supports the implementation of the 'best interests' test and the provisions which encourage greater and better disclosure in the rendering of financial services. However, CSA also believes that the consultation needs to consider the wider implications of reform to the Act. The exposure draft will have wider reaching effects on financial services practices in a diverse number of organisations, and it is important that all the potential consequences of changes to the legislation are canvassed before the exposure draft is confirmed as legislation.

CSA would be more than happy to elaborate on our concerns, as required.

Yours sincerely

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CHIEF EXECUTIVE