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LAWYERS

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Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Madam

Inquiry into the provisions of the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* (Bill)

Thank you for the invitation to make a submission on the Bill. We appreciate the opportunity to make a submission to the Senate Economics Legislation Committee and we have also taken the opportunity to comment on certain aspects of the Exposure Draft of the *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation 2014* (**draft Regulations**) which is an important part of the Government's plan to improve the Future of Financial Advice (**FOFA**) legislation.

Minter Ellison is a full service commercial law firm. We advise major financial institutions, including banks, insurance companies and superannuation funds, as well as specialist fund managers, financial advice firms, stockbrokers and other financial intermediaries. We are therefore well placed to identify and understand the implications of the Bill and draft Regulations for both providers and consumers of financial services.

We note however that the views expressed in our submission are ours alone and do not necessarily reflect the views of our clients.

1. Overview

We welcome the changes proposed by the Government in the Bill and the draft Regulations. While we support the objectives of the FOFA legislation to promote a professional financial advice sector, we have been concerned that certain aspects of the FOFA legislation are inconsistent with the equally important goal of ensuring an efficient, fair and innovative financial sector. Another critical but often overlooked goal of FOFA was 'to provide access to and [expand] affordability of financial advice'. We believe that the reforms proposed by the Government will help ensure that the FOFA legislation meets these goals.

In particular, we support:

(a) the repeal of s 912B(2)(g) (item 10 of Schedule 1 of the Bill);

(b) facilitating the provision of scaled advice (item 13 of Schedule 1 of the Bill);

(c) the repeal of the opt-in notice requirement (items 17-21 of Schedule 1 of the Bill);

(d) the exclusion of general advice from the prohibition on conflicted remuneration, in particular where it is given by or on behalf of the product issuer (s 963B(6), inserted by item 29 of Schedule 1 of the Bill);

(e) the ability to modify the provisions of FOFA by way of regulation or by ASIC;

(f) the amendments to the ban on volume-based shelf space fees (items 36-38 of Schedule 1 of the Bill);

(g) the introduction of a specific exemption for performance bonus schemes (draft Regulation 7.7A.12EB);

(h) attempts to facilitate adviser movement without loss of grandfathering (draft Regulations 7.7A.16A(5A) and 7.7A.16B(4A)); and

(i) the exemption for pass through remuneration (draft Regulation 7.7A.12HA).

In some cases, we believe that the provisions mentioned above require some amendment to be effective and we have indicated where this is the case in our detailed comments on these and a number of other provisions of the Bill and draft Regulations below.

2. Submissions on the Bill

2.1 Best interests duty - Removal of the 'catch-all' step

We support the removal of the best interests duty 'catch-all' provision in s 961B(2)(g) of the *Corporations Act 2001* (Cth) (**Corporations Act**). The removal of the provision is consistent with the original purpose of s 961B(2) to act as a safe harbour for compliance with the best interests duty by setting out what an adviser needs to do to comply with the duty. Including a requirement to take 'any other step that … would reasonably be regarded as being in the best interests of the client' means that s 961B(2) cannot operate as a safe harbour because an adviser is still required to determine what might need to be done to act in the client's best interests. It means that s 961B(2) does not provide the certainty that it is was designed for.

We do not believe that the removal of the 'catch all' step will weaken the obligations applying to advisers for the following reasons:

(a) The obligation in s 961B is only one of three key obligations in Division 2 of Part 7.7A of the Corporations Act. In our view, the most important duty is the requirement in s 961J for advisers to give priority to client interests when giving advice. It is this client priority rule which is the essential element of a fiduciary duty. It governs all aspects of the role undertaken by an adviser in giving advice and it does not have any limitation on its operation where it applies.

    It is not therefore possible for an adviser to act in their own or their licensee's interests when giving advice. This includes deciding the scope and type of advice that the adviser believes that the client requires.

(b) Advisers are also required to ensure that they only provide advice to the client if it would be reasonable to conclude that the advice is appropriate to the client (s 961E). Advisers must therefore conclude that the advice given to clients is appropriate for those clients.

(c) The obligation to 'act in the best interests of the client in relation to the advice' (s 961B(1)) was only ever intended to address the process of providing advice. This is confirmed in the Explanatory Memorandum for the FOFA legislation:

> *1.22 The principle guiding the application of the best interests obligation is that meeting the objectives, financial situation and needs of the client must be the paramount consideration* ***when going through the process of providing advice****. This principle is embedded in the framework for the best interests obligation.*
>
> *1.23 There are steps that providers may prove they have taken to demonstrate that they have acted in the best interests of the client.* ***These steps recognise that the requirement to act in a client's best interests is intended to be about the process of providing advice, reflecting the notion that good processes will improve the quality of the advice that is provided.*** *The provision is not about justifying the quality of the advice by retrospective testing against financial outcomes.* (emphasis added)

The steps in s 961B(2) are therefore designed to set out the steps that will satisfy the general obligation s 961B(1) to ensure that client interests are given priority 'when going through the process of providing advice.' It can be seen from these references that, despite being the first mentioned duty in Division 2 of Part 7.7A, s 961B is not and was never intended to be the paramount duty applying to advisers. The paramount duty is the client priority rule in s 961J. Section 961B simply supplements this duty by confirming that this duty also applies to the process of giving advice.

2.2 Best interests duty – Re-ordering the steps to satisfy safe harbour

Items 7 and 8 of Schedule 1 of the Bill propose to re-order the safe harbour steps so that the first step becomes the third step. We agree that it makes more sense for an adviser to identify the subject matter of the advice sought before identifying the client's relevant circumstances. It is therefore appropriate for s 961B(2)(b) to be the first step.

However, s 961B(2)(b)(ii) already requires the adviser to identify the circumstances of the client relevant to advice sought on the subject matter of the advice sought. The proposed s 961B(2)(ba) seems in effect therefore to simply repeat s 961B(2)(b)(ii). We submit that s 961B(2)(ba) is therefore unnecessary and could be removed from the Bill.

2.3 Best interests duty – Scaled advice

We welcome the proposal to give explicit recognition to the ability of the client to agree on the scope of the advice. This ensure that client's can obtain the advice they require without having to pay for advice they do not want.

2.4 Conflicted remuneration – General advice exemption

We believe that it is appropriate for general advice given by or on behalf of product issuers to be excluded from the ban on conflicted remuneration.

General advice can be given in many different circumstances: in brochures, on the internet, in correspondence and by call centre and branch staff. In each case, the motivation of the provider is clear. Product issuers are naturally and appropriately concerned to promote their products. There is no doubt that is exactly what retail clients would expect them to do. Product issuers and their staff will have a strong interest in the success of their products however they are remunerated and we submit that there is therefore no need to regulate their remuneration.

There are of course important protections for consumers in relation to the conduct of product issuers and their representatives, including the prohibition on misleading and deceptive conduct in ss 12DA and 12DB of the ASIC Act and ss 1041E and 1041H of the Corporations Act, the requirement to give general advice and advertising warnings in ss 949A and 1018A of the Corporations Act, restrictions on unsolicited contact with clients in ss 992A and 992AA of the Corporations Act and product disclosure requirements in Part 7.9 of the Corporations Act. We submit that these protections provide the appropriate and a sufficient level of protection in relation to general advice, which by its very nature is advice given in circumstances where a reasonable person would not expect that the advice took into account any of the person's their relevant circumstances (as required by the definition of personal advice in s 966B(3)).

We do however have the following concerns regarding the exemption proposed in s 963B(6) inserted by item 29 of Schedule 1 of the Bill:

(a) The exemption is limited to employees of licensed product issuers. In practice, it is unusual for product issuers or licensees to employ staff directly. In most corporate groups, a related service company will be the employer of staff for all or most companies in the group. Even in cases where a product issuer such as a bank is the group employer, the product issuer is unlikely to be the issuer of the particular products in question. For example, where a bank is the group employer, the bank will only issue banking products. It will not issue other financial products such as life insurance, managed investment or superannuation products. As there is a separate exemption for banking products (see for example s 963D), the general advice exemption will have a useful role to play in such a case. (We note that the reference to 'sold' in proposed s 963B(6)(c) is unlikely to address this concern as 'sold' is likely to be interpreted as limited to entities which transfer ownership of a product owned by the entity which is only rarely the case.)

(b) Product issuers do not only promote products through employees. In many cases, they engage staff as contractors or engage third party providers, such as call centres, to provide services in the name of the product issuer. However, there is no difference for the consumer whether they are dealing with an employee or a contractor and they would not normally know. As far as they are concerned, they are dealing with the product issuer and would expect the product issuer's products to be promoted to them (subject of course to the protections noted above).

    We note that this issue has been identified and addressed in the exemption for representatives of authorised deposit-taking institutions (ADIs) which applies not only to employees but also to agents of ADIs and others acting under the name of an ADI (see for example s 963D).

We therefore submit that s 963B(6) should be amended to:

(i) also apply to employees of related bodies corporate of the product issuer; and

(ii) be extended to agents of the product issuer and others acting under the name of the product issuer.

2.5 *Modification powers*

Unlike Parts 7.6, 7.7, 7.8 and 7.9 of the Act,[1] Part 7.7A does not provide general exemption and modification powers to ASIC or by regulation. The following regulation making powers are currently or proposed to be included in Part 7.7A:

Provision/s	Regulation-making power
Current Part 7.7A	
s 961B(5)	To specify steps required/not required to satisfy the best interests duty
s 961F(e)	To designate certain financial products as 'basic banking products'
s 962A(5)	To prescribe that certain arrangements are 'not ongoing fee arrangements'
ss 962G(2), 962S(2)	To provide that the obligation to provide a fee disclosure statement does not apply in particular situations
ss 962H(1)(b)(ii), 962H(2)(f), 962H(3)	To modify the content requirements for fee disclosure statements
s 962K(3)	To provide that the obligation to provide a renewal notice does not apply in particular situations
ss 963C(c)(iii), 963C(d)(iii), 963C(f)	To provide that non-monetary benefits given in certain circumstances are not conflicted remuneration
ss 964D(4), 964E(3)	To provide that the ban on asset-based fees on borrowed amounts does not apply in particular situations
Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014	
Proposed s 963B(7)	To provide further detail regarding when a monetary benefit is not conflicted remuneration
Proposed s 963C(2)	To provide further detail regarding when a non-monetary benefit is not conflicted remuneration
Proposed s 963D(3)	To provide further detail on the application of the ban on conflicted remuneration to recommendations made by employees of ADIs in relation to basic banking, general insurance, and consumer credit insurance products

We welcome the inclusion of additional powers in the Bill to make regulations to modify the effect of exemptions to the ban on conflicted remuneration. Inclusion of these powers will enable the Government to make appropriate adjustments to the exemptions.

However, we submit that a broader exemption and modification power should apply to Part 7.7A and should be available to ASIC as well as the Government (by regulation) consistent with the equivalent powers in other Parts of Chapter 7 of the Corporations Act. This will facilitate the making of appropriate adjustments to the FOFA regime to resolve uncertainties or anomalies and thereby enhance certainty, efficiency and good conduct in the financial advice sector.

[1] See ss 926A, 926B, 951B, 951C, 992B, 992C, 1020F and 1020G. ASIC's power in relation to Part 7.6 does not extend to Division 4 (applying for, varying and cancelling an Australian financial services licence) or Division 8 (banning and disqualification) of that Part.

Without general exemption and modification powers, ASIC has been forced to rely on giving no-action positions, for example in relation to fee disclosure statement obligations. This is a particularly unsatisfactory outcome as it only provides limited protection against enforcement action by ASIC. It does not address civil liability and means that businesses are still breaching the law.

We note that all regulations and ASIC class orders must be tabled in Parliament and are therefore subject to appropriate Parliamentary scrutiny, with the opportunity for either House to disallow them. We also note that the practice of ASIC in making class orders has been quite conservative and demonstrated a recognition of the supremacy of Parliament by not seeking to exercise its powers in a manner that would result in outcomes which are inconsistent with the policy objectives of legislation made by Parliament. On that basis, we submit that there is no reason not to include general exemption and modification powers in Part 7.7A.

2.6 Life risk insurance through superannuation

The Bill does not amend the restriction on the exemption from the ban on conflicted remuneration for life risk insurance provided through a superannuation fund. In the Exposure Draft of the Bill, the Government did attempt to adjust this exemption so that it would work better.

However, we submit that the restriction on the exemption for life insurance should simply be removed. Retaining this restriction creates a significant anomaly meaning that commission can be paid in relation to life insurance outside superannuation but cannot be paid in some circumstances when provided through a superannuation fund. We believe that the rationale for exempting life insurance from the ban – the nature of life insurance is such that it needs to be sold, the commission is included in the price of the product and there is a strong public interest in promoting life insurance coverage in the community – apply equally whether life insurance cover is provide through superannuation or not.

Alternatively, if Parliament is concerned about the possible impact of commission in relation to life insurance made available through superannuation in relation to default members, we suggest that the restriction could be simplified by limiting it to insurance provided through a MySuper product where the client has not received personal advice in relation to joining or remaining in the product.

2.7 Fee disclosure statements (FDSs)

We submit that the amendment to remove the requirement to provide yearly fee disclosure statements to existing clients (item 22 of Schedule 1 of the Bill) should apply from 1 July 2013, the date this obligation commenced.

We are concerned that if this change is not made retrospective advisers and licensees will have the uncertainty of being subject to a requirement that was in force for a short period of time. Given the Government's announced policy that this requirement would be repealed, we submit that it was reasonable for licensees who had been unable to comply fully with the obligation before the election to not take further steps to comply with it after that time given its imminent repeal. We are aware that licensees have in fact relied on this position, as well as ASIC's no-action positions in relation to FDSs and its facilitative approach to compliance in the initial period after FOFA commencement. We submit that in these circumstances it is not appropriate for licensees and advisers to be subject to possible penalty or liability for failure to give an FDS or any breach of the FDS obligations in this period.

We understand that concerns may have been raised that the repeal of this obligation retrospectively could amount to an acquisition of property by the Commonwealth on unjust terms and thereby infringe s 51(xxxi) of the Constitution, the property in question being the right of consumers to receive an FDS. We acknowledge that there may be some basis for this concern if the legislation purported to remove a consumer's contractual right to receive an FDS. However, we do not believe it has any application in relation to the repeal of an obligation imposed by legislation in the first place.

2.8 Volume-based shelf-space fees

We welcome the changes proposed in the Bill in relation to the ban on volume-based shelf space fees (items 36-38 of Schedule 1). In particular, we believe that it is appropriate to limit the application of the ban so that it only applies where the fees may influence the platform operator to give preferential treatment to the fund manager's products. The exclusion of insurance and banking products is also consistent with the original intent of the ban as demonstrated by the reference to the application of the ban to 'fund managers' in the current provision.

However, we submit that the ban on shelf-space fees should also be limited to retail platforms. At the moment, there is no such restriction which leads to the anomalous outcome that ban on these types of fees could extend to the wholesale market which we do not believe is appropriate.

2.9 Intrafund advice

We are concerned that the proposal to refer to 'intrafund advice' in a note (item 29 of Schedule 1 of the Bill) will not be particularly useful. We submit that the term should be properly defined and excluded from the operation of the ban on conflicted remuneration.

There are circumstances where a superannuation trustee may wish to delegate its ability to provide intrafund advice. When such delegation occurs, the trustee needs to be in a position to pay the adviser. On this basis, intrafund advice should be excluded from the ban on conflicted remuneration.

3. Submissions on the draft Regulations

3.1 Performance bonuses based on volume

We welcome the proposal to include an exemption for performance bonuses. It is important for licensees to be able to recognise representatives who are doing a good job. While many of the measures will relate to the quality of the work performed, we believe it is appropriate to be able to include some measures which give representatives a stake in the work they are doing. This approach enhances engagement and ensures a better service experience for clients. We also agree that it important to ensure that representatives who receive these types of benefits are at least equally incentivised to comply with their obligations and in particular the obligations arising under Division 2 of Part 7.7A.

Nevertheless, we believe that the following improvements that can be made to proposed Regulation 7.7A.12EB:

(a) There is no reason to limit the exemption to employees. Licensees often engage contractors on a short or long-term basis in place of or in addition to employees. Furthermore, where a performance bonus represents a small proportion of total remuneration, it should not matter whether the adviser is an employee or authorised representative.

(b) It should be made clear that the exemption will apply where the benefit is partly dependent on financial products not otherwise exempt. In other words, the low value requirement should only be based on products for which conflicted remuneration may be paid. Where the bonus also includes measures relating to exempt products such as insurance and basic banking products, the total value of the bonus should be able to be larger provided the part relating to the non-exempt products would only give rise to a 'low value' benefit.

(c) There is no need for the exemption to refer to a 'class of retail clients' given conflicted remuneration relating to general advice is to be made exempt in any case.

(d) We submit that the last element of the exemption, paragraph (f), should not require advisers to provide advice which is in 'the best interests of the client'. This would prevent the exemption being used in conjuction with the safe harbour in section 961B(2). We note that licensees are required to take reasonable steps to ensure that their representatives comply with the requirements of Division 2 of Part 7.7A under section 961L in any case. There is therefore no need to include paragraph (f) in the exemption. However, if it is retained, then we submit that it should simply refer to ensuring compliance with the obligations of Division 2 of Part 7.7A.

3.2 Changing grandfathered arrangements

Licensees continue to face difficulties with respect to existing arrangements. The legislation provides that remuneration will be grandfathered if paid under an arrangement that was entered into before 1 July 2013. However there is no indication regarding the extent to which changes may be made to existing arrangements without losing grandfathering. ASIC has provided regulatory guidance that such changes will not result in a loss of grandfathering where they are not material. However, this does not provide certainty for industry participants.

We submit that the ability to amend grandfathering arrangements without the loss of grandfathering should be recognised in the legislative framework. The legislation should also specify the circumstances in which changes will be permitted.

3.3 Permitting adviser movements

We welcome the proposal to amend Regulation 7.7A.16F to permit movements of authorised representatives between licensees and to permit employed representatives to become authorised representatives and to permit grandfathering to extend to purchasers of businesses under draft Regulations 7.7A.16A(5A) and 7.7A.16B(4A).

However, these changes do not address all of the concerns relating to restrictions on adviser movements. In particular, the change to permit authorised representatives to move between licensees will not in fact allow authorised representatives to take grandfathered remuneration with them when they move licensees where the remuneration is received by their current licensee and passed on by the licensee to the representative. In this common scenario, the Regulations will not permit the new licensee to receive the grandfathered remuneration where the new licensee does not have an existing arrangement with the product issuer for payment of remuneration for transferring advisers.

We submit that there needs to be an explicit exemption given to permit grandfathered remuneration to be paid to an adviser's new licensee where the adviser ceases to represent a licensee to whom grandfathered remuneration was being paid in respect of the adviser. It is important that the exemption applies to any new licensee – in other words, the exemption should not be limited to the first time an adviser moves between licensees.

3.4 Passing on benefits

We welcome the proposal in draft Regulation 7.7A.12HA for benefits calculated by reference to exempt benefits to be also exempt. Once a benefit is exempt it should remain exempt. Any other outcome will produce significantly complexity for clients having to agree not only to the benefit they are giving to the licensee but also to the remuneration paid to individual advisers.

We note that the heading to this Regulation states that it applies to grandfathered benefits and we agree that it should. However, Regulation 7.7A.16F may prevent Regulation 7.7A.12HA applying to grandfathered benefits. Regulation 7.7A.16F appears to operate as a restriction on the circumstances in which grandfathered benefits can be passed on to advisers – not only does it state that no more than 100% of the benefit can be passed on Regulation 7.7A.16F(b) also states that benefits can only be passed on if give under an arrangement entered into before 1 July 2013. Unless this paragraph is removed from 7.7A.16F, there will at best be uncertainty whether Regulation 7.7A.12HA can operate in relation to grandfathered benefits irrespective of the reference to them in its heading.

3.5 Delay in introducing regulations

We note that there have been significant delay in introducing the regulations proposed by the Government. That process is now 'paused' and it seems unlikely that any regulations will be made before June. This is causing considerable difficulty for industry, particularly relation to obligations due to commence on or around 1 July 2014 – employee remuneration and the cessation of grandfathering for certain new investments.

We therefore submit that there should be a further extension to comply with the FOFA regime in relation to conflicted remuneration for at least an additional six months.

Yours faithfully
MINTER ELLISON

Richard Batten
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