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Legislation Committee

Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 [Provisions]

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Senate Economics Legislation Committee

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Introduction

Referral

1.1 On 20 March 2014, pursuant to the Selection of Bills Committee's report, the Senate referred the provisions of the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 (the bill) to the Finance and Public Administration Legislation Committee for inquiry and report.[1] Later that day, the Senate varied this order to provide that the provisions of bill be referred to the Economics Legislation Committee for inquiry and report by 16 June 2014.[2]

1.2 The main reason for supporting the referral of this legislation to a parliamentary committee was to 'provide a forensic and detailed examination' of the legislation and the effects this and previous reforms would and have had on the financial services and investment decisions.[3]

Conduct of the inquiry

1.3 The committee advertised the inquiry on its website and wrote to relevant stakeholders and other interested parties inviting submissions. The committee received 36 submissions, which are listed at Appendix 1.

1.4 The committee held a public hearing in Canberra on 22 May 2014. The names of the witnesses that gave evidence are at Appendix 2.

Background to the bill

1.5 In April 2010, the former government announced a package of reforms called the Future of Financial Advice (FOFA). On 13 October 2011, the Corporations Amendment (Future of Financial Advice) Bill 2011 was introduced into the House of Representatives. On that day, the House of Representatives referred the bill to the Parliamentary Joint Committee for Corporations and Financial Services (PJC) for inquiry and report. Six weeks later, on 24 November 2011, the Australian Government introduced the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011. This bill was also referred to the PJC for inquiry and report. Both bills were referred to the Senate Economics Legislation Committee (the committee) for inquiry and report by 14 March 2012.

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1 Selection of Bills Committee, *Report No. 3 of 2014*, 20 March 2014.

2 *Journals of the Senate*, 20 March 2014, p. 685.

3 Appendix 2, Selection of Bills Committee, *Report No. 3 of 2014*, 20 March 2014.

1.6 The two bills represented the government's response to the PJC's 2009 inquiry into financial products and services in Australia that considered issues associated with corporate collapses, including Storm Financial and Opes Prime.[4] They proposed to amend the *Corporations Act 2001* (Corporations Act) to change the way the financial advice industry in Australia was regulated.

1.7 Together, the two bills were to implement the government's Future of Financial Advice ('FOFA') reforms. Their focus was on developing a framework for the provision of financial advice in Australia with the underlying objective:

> …to improve the quality of financial advice while building trust and confidence in the financial advice industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest.[5]

1.8 The reforms were also intended to facilitate access to financial advice through the provision of simple or limited advice. In particular, the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 set up a framework which included the following features:

- a best interests obligation for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients—the best interests obligation;
- a ban on conflicted remuneration, including product commissions, where licensees or their representatives provided financial product advice to retail customers; and
- a requirement for ongoing advice fees to be actively renewed by retail clients every two years.[6]

1.9 The PJC delivered its report on both the FOFA bills in February 2012, which included a dissenting report from coalition members that put forward 16 recommendations for changes to FOFA. At that time, the Coalition referred back to the findings and recommendations of the PJC's 2009 report, which it had supported, and in its view:

> …provided a blueprint the government could have adopted with bipartisan support, to make important improvements to our financial services

4 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

5 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

6 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

> regulatory framework to further enhance Australia's already first class regulation of the financial services industry.[7]

1.10 The Coalition was concerned that the PJC's 'very sensible and widely supported recommendations' had been jettisoned and that the FOFA legislation was 'too complex, costly to implement and created unnecessary red tape'.[8] It found the FOFA package of legislation as drafted 'unnecessarily complex and in large parts unclear' and, according to conservative industry estimates, 'likely to cost $700 million to implement and a further $350 million per annum for compliance'. Coalition members concluded that the legislation would lead to 'increased costs and reduced choice for Australians seeking financial advice'.[9] They could not support the proposed legislation.

1.11 Clearly, the reforms proposed by FOFA underwent extensive consultation, close scrutiny and generated considerable debate in parliament. The bills passed both houses with amendments, received royal assent on 27 June 2012 and the FOFA amendments commenced, on an optional basis, from 1 July 2012, and became compulsory from 1 July 2013.[10]

1.12 In July 2013, a few months before a general election, the Coalition, then in opposition, announced that after consulting widely for 18 months, it had developed a plan of action that would reduce the regulatory burden. Although it agreed with the policy intent of FOFA, in its view FOFA's 'unnecessarily heavy compliance burden' was 'strangling Australia's economic prosperity and development'.[11] The Coalition's intention was to have legislation accurately reflect the recommendations of the PJC's 2009 report.

1.13 Part of this plan involved amending the FOFA legislation to reduce compliance costs for small business, financial advisers and consumers who accessed financial advice. The plan cited the Financial Services Council, which estimated that the FOFA package would cost an estimated $700 million to implement and impose a $375 million compliance burden on the financial services industry each year. The Coalition stated that it would implement all 16 of its recommendations outlined in its 2012 dissenting report in an endeavour to reduce compliance costs.[12]

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7 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 152.

8 Explanatory Memorandum, Outline, p. 3.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, pp 152–153.

10 Explanatory Memorandum, Outline, p. 3.

11 Explanatory Memorandum, Outline, p. 3.

12 *The Coalition's Policy to Boost Productivity and Reduce Regulation*, p. 26.

1.14 After the election, and consistent with its stated intention, the new Coalition government proceeded to implement its action plan. On 20 December 2013, the then Assistant Treasurer, Senator the Hon Arthur Sinodinos AO, announced amendments to improve FOFA. The key elements of the government's proposed amendments included:

- the complete removal of opt-in—so that clients no longer needed to complete unnecessary paperwork in order to continue their arrangement with their adviser;
- the simplification and streamlining of the additional annual fee disclosure requirements—remove the retrospective application of the fee disclosure requirement so that advisers would not need to provide fee disclosure statements to clients who entered into a fee arrangement before 1 July 2013;
- improve the best interests duty—remove the 'catch-all' from the best interests duty to ensure that advisers could be confident that they had provided compliant advice to their client;
- provide certainty around the provision and availability of scaled advice—amend the best interests duty to explicitly allow for the provision of scaled advice that would enable advisers to agree with their clients on the scope of advice to be provided whilst ensuring that the advice was still appropriate for the client; and
- exempt general advice from conflicted remuneration—ensure that the ban on conflicted remuneration only applied to personal financial advice.[13]

1.15 The government released draft regulations and legislation on its announced reforms to FOFA for public consultation on 29 January 2014.[14] Fifty-seven written submissions were received and various consultation meetings held.[15] When releasing the draft legislation, Senator Sinodinos explained:

> The Government is supportive of the principles of FOFA, but the previous Government's reforms are unwieldy, burdensome and unnecessarily complex. The proposed reforms will reduce the burden on industry and pressures on the cost of advice to consumers.[16]

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13 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, Delivering affordable and accessible financial advice' http://axs.ministers.treasury.gov.au/media-release/011-2013/ (accessed 24 April 2014).

14 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, Delivering affordable and accessible financial advice' http://axs.ministers.treasury.gov.au/media-release/011-2013/ (accessed 24 April 2014).

15 Explanatory Memorandum, Outline, p. 5.

16 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, 'Future of financial advice (FOFA) amendments released for public consultation', 29 January 2014, http://axs.ministers.treasury.gov.au/media-release/002-2014/ (accessed 24 April 2014).

1.16 The consultation period lasted for three weeks, with submissions closing on 19 February 2014. The Assistant Treasurer anticipated that the bill would be introduced into Parliament in the 2014 autumn sittings with passage scheduled for the winter sitting period.[17] It should be noted that, in response to the feedback received during this consultation period, the government made further adjustments to the exposure draft particularly in the area of the carve-out for conflicted remuneration. The government has narrowed the broad exemption from this ban on conflicted remuneration to more specific areas of general advice.

1.17 In accordance with this schedule, the government introduced the bill into the House of Representatives on 19 March 2014. At that time, the Parliamentary Secretary to the Treasurer reinforced the government's message that the package of amendments contained in the bill would 'significantly reduce regulatory costs and provide greater certainty to industry in relation to their legal obligations'. [18]

Purpose of the bill

1.18 The bill is intended to implement the government's election commitment to reduce compliance costs imposed on the financial services industry by amending Part 7.7 of the *Corporations Act 2001* (the Act). The bill includes the following key amendments to FOFA:

- removes the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement);
- makes the requirement for advisers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013;
- removes paragraph 961B(2)(g), the 'catch-all' provision, from the list of steps an advice provider may take in order to satisfy the best interests obligation;
- better facilitates the provision of scaled advice; and
- provides a targeted exemption for general advice from the ban on conflicted remuneration in certain circumstances.[19]

Structure of this report

1.19 To provide the context for the examination of the provisions of the bill, the committee first provides an overview of the objectives of the FOFA reforms. In separate chapters, the committee then considers the following key amendments contained in the bill:

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17 Senator the Hon Arthur Sinodinos AO, Assistant Treasurer, 'Future of financial advice (FOFA) amendments released for public consultation, 29 January 2014, http://axs.ministers.treasury.gov.au/media-release/002-2014/ (accessed 24 April 2014).

18 The Hon Steven Ciobo MP, Parliamentary Secretary to the Treasurer, *House of Representatives Hansard*, 19 March 2014, p. 2371.

19 Explanatory Memorandum, p. 4.

- the best interests duty;
- scaled advice and the best interests obligations;
- modified best interests obligations;
- conflicted remunerations and exemptions; and
- opt-in provisions and fee disclosure statements.

Acknowledgements

1.20 The committee thanks all those who participated in, and assisted the committee with, the inquiry.

Chapter 2

FOFA reforms—objectives

2.1 The original FOFA reforms were welcomed by both consumers and industry as a significant step forward in the financial services sector. CPA Australia and the Institute of Chartered Accountants Australia encapsulated the positive reception that the reforms received:

> The passage of the FoFA reforms was the result of extensive, wide spread consultation over many years. Its introduction marked a milestone opportunity for the sector to take a greater responsibility and refocus its efforts on providing and promoting quality financial advice in the best interests of the client, free from conflict and in a transparent manner.[1]

2.2 FOFA sought to strike a balance by 'introducing further consumer protections while simultaneously requiring financial advisers to meet higher standards of care and skill'.[2]

Australia's financial services industry

2.3 The proposed legislation recognises the importance of the financial services industry in the Australian economy, which currently employs over 400,000 people and, according to the regulation impact statement, is the largest industry in Australia when measured by gross value added. The industry is expected to grow as Australia's population ages and superannuation funds continue to expand.[3]

2.4 In this environment, Australians are looking increasingly to financial advisers for assistance. Financial products, however, are difficult to understand even when they are called basic products and the cost of financial advice is of major consideration for consumers.[4] ASIC observed:

> Today's consumers are being asked to make more financial decisions than ever before and the environment in which they are making those decisions is becoming increasingly complex.[5]

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1 *Submission 14*, covering letter.

2 Governance Institute of Australia, *Submission 11*, p. 2.

3 Regulation Impact Statement, p. 45.

4 See for example, Mr Fox, AFA, *Proof Committee Hansard*, 22 May 2014, p. 3 and Mr Kirkland, CHOICE, *Proof Committee Hansard*, 22 May 2014, p. 11.

5 ASIC, Report 224, *Access to financial advice in Australia*, December 2010, Executive Summary, paragraph 1.

Financial advice

2.5 The Financial Services Council (FSC) commissioned research from KPMG Econtech, which showed:

> …individuals with a financial adviser saved an additional $1,590 each year (after the cost of the initial advice) when compared to a similar individual without a financial adviser. These savings alone equated to an additional $91,000 upon retirement for a 30 year old Australian. The KPMG Econtech research also found that if an additional five per cent of Australians received financial advice, national savings would increase by $4.2 billion (or 0.3 per cent of GDP) by 2016–17.[6]

2.6 Even so, ASIC found that, while many consumers were ill-equipped to make sound financial decisions and would benefit from better access to financial advice, fewer than 40 per cent of the Australian adult population have ever used a financial planner.[7] It highlighted the value of obtaining financial advice:

> Most people could benefit from access to quality personal or general advice and factual information, especially at the time of key life events or transitions (e.g. starting a family, preparing for retirement or managing an unexpected redundancy). Industry studies have shown that consumers who access financial advice benefit financially as a result of the advice, even after the cost of the advice is taken into account. The financial benefits of advice can include increased savings, less interest expense through faster debt reduction or higher investment returns.[8]

2.7 ASIC's review of investment trends research revealed 'a significant disconnect between the amount consumers are willing to pay for financial advice and the typical costs to licensees of providing financial advice'. It found that on average, consumers believed that initial advice should cost $301 and ongoing advice should cost $298 per annum. Twenty-two per cent of consumers believed that the initial advice consultation should be free.[9] The regulation impact statement recorded further that the cost of providing comprehensive financial advice to a client actually ranges between $2,500 and $3,500.[10] Thus cost was a major consideration, as ASIC observed:

> The relatively low amounts consumers are prepared to pay for financial advice, and the sizeable proportion of people who are not willing to pay

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6 *Submission 27*, p. 5.

7 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 4. ASIC cited recent survey results which suggested that 20% to 40% of the Australian adult population use or have used a financial adviser. This means that 60% to 80% of adult Australians have never used a financial adviser.

8 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 8.

9 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 25.

10 Regulation Impact Statement, p. 52.

> anything at all, suggests that many consumers do not fairly value professional financial advice.[11]

2.8 Consistent with the ASIC findings, the Financial Services Council quoted from Roy Morgan research which suggested that Australian consumers perceive the cost of a personalised financial plan to cost less than $1000 (76%). The research found:

> The most frequently reported price expectation was $200–$499 (36%). Only 2% of consumers expected a personal financial plan to cost more than $2000 (even though 20% of consumers have an adviser and 20% have had an adviser in the past). If faced with the need for a comprehensive personalised financial plan, 84% would not pay for the advice. Instead 69% of those surveyed who could not afford the comprehensive personalised financial plan would seek advice from their friends and family, 61% would source advice from the internet and 27% would access financial blogs.[12]

2.9 Importantly, ASIC also made the point that improving access to advice 'is not about providing inferior quality advice to consumers or assisting financial services licensees to simply sell more products to consumers'.[13]

2.10 The main purpose of this bill is to reduce compliance burdens while maintaining consumer protection: to align incentives, improve transparency and improve the basis on which financial advice is provided to consumers.[14] The Explanatory Memorandum states that:

> The proposed amendments to FOFA seek to navigate the fine line between ensuring that unnecessary and burdensome regulations that drive up the cost of business are removed, whilst ensuring that the consumer protections of FOFA are maintained.[15]

2.11 Thus, one of the key challenges for the FOFA reforms is to find the right balance between providing consumer protection and ensuring that consumers have access to affordable and competent financial advice. As Mr Brad Fox, Association of Financial Advisers, noted:

> Every day, Australians face life-defining moments that require financial decision making. Every day, they turn to financial advisers to support them through these challenges.

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11 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 26.

12 *Submission 27*, p. 9.

13 ASIC, Report 224, *Access to financial advice in Australia,* December 2010, p. 11.

14 Explanatory Memorandum, Outline, p. 4 and Meghan Quinn, Treasury, *Proof Committee Hansard*, 22 May 2014, p. 94.

15 Explanatory Memorandum, paragraph 5.60.

2.12 In his view, the FOFA amendments were designed to help people gain access to financial advice and increase the probability that those going through life-defining financial challenges would be able to get affordable, quality financial advice.[16]

2.13 Taken as a whole, submitters agreed that it was imperative to achieve the right balance between acting in the best interests of consumers and reducing regulatory obligations. They appreciated that the original twin objectives of FOFA were to rebuild trust and confidence in the industry and to expand the affordability and accessibility of financial advice. Submitters also recognised the importance for Australians to receive the right financial advice. For example, Mr Paul Drum, CPA Australia, stated that it was:

> …critical to bear in mind the continued low levels of financial literacy within the community and, more generally, the low levels of engagement that consumers have with their finances, including superannuation…not every consumer needs a holistic financial plan or to be recommended a financial product. Many Australians will not have complex financial situations or positions. Rather, all they want is the ability to speak or work with a highly competent professional adviser that they can trust.[17]

2.14 Mr Richard Batten, Minter Ellison Lawyers, reinforced the message that Australians need access to competent professional advice. He acknowledged that:

> …it is important that consumer protection is achieved without imposing an undue burden on industry. Regulation should not unnecessarily increase costs or reduce the availability of services for consumers, because good and timely financial advice is an integral part of future wealth creation. We therefore believe the committee has an important job to do to ensure that the government's FoFA amendment bill enhances the accessibility and availability of good quality financial advice.[18]

2.15 While there was general and keen support for the objectives of the FOFA reforms, submitters differed in their views on whether the proposed reforms would either enhance or detract from these objectives. The Governance Institute of Australia noted the continuing commentary about 'whether or not the right balance has been struck'. It observed that the current round of reforms was 'aimed at redistributing the balance with a view to ensuring that financial advisers are not burdened with unnecessary compliance requirements'.[19]

2.16 Some submitters were of the view that the balance that the bill sought to achieve leant too far in favour of industry and not toward consumer protection. They sought to highlight the enormous gap in knowledge and experience between the

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16 *Proof Committee Hansard*, 22 May 2014, pp 1 and 3.

17 *Proof Committee Hansard*, 22 May 2014, p. 29.

18 *Proof Committee Hansard*, 22 May 2014, p. 36.

19 *Submission 11*, p. 2.

providers of financial services and the retail consumers. For example, National Seniors Australia described the financial services sector as a classic uneven market, where the participants were 'grossly mismatched':

> You have huge corporations, heavily vertically integrated, selling complex products, and financial advisers, who historically have lacked professional standards and education…On the other side, you have consumers, who generally lack understanding or appreciation of the complexity of products and, to a significant extent, lack the financial literacy to deal with them. In such a market, it is proposed to reduce consumer protection, and that is the foundation for our concern.[20]

2.17 In general, those opposing the proposed changes shared the view that the proposed amendments would undermine the consumer protections embedded in the current legislation. Ms Robbie Campo, Industry Super Australia, was concerned that the measures proposed in the bill would significantly dilute key consumer protections in financial advice law and therefore increase the likelihood and impact of future financial advice scandals.[21]

2.18 Similarly, Ms Josephine Root, Council of the Ageing (COTA), feared that the cumulative effect of the changes would seriously weaken the reforms, thereby 'giving less consumer protections and ultimately undermining confidence in the financial advice sector'. She stated that COTA was concerned that people would 'opt out of getting financial advice and, therefore, not get the maximum benefits that they could'.[22] COTA believed that, if implemented, the proposed amendments would wind back the provisions of FOFA significantly, result in considerable consumer detriment, and undermine consumer trust and confidence in the financial advice industry.[23]

2.19 Initially, CHOICE was unhappy with the compromise reached when FOFA was first enacted, which it believed could have been stronger in consumer protection. It regarded the proposed amendments as tilting 'the balance further away from consumers'. In its view, the process to justify the bill had failed to assess thoroughly the cost of proposals to consumers.[24] Mr Alan Kirkland explained that CHOICE did not regard FOFA as 'the gold standard in consumer protection'. Although, it was a significant step forward, CHOICE believed that FOFA could have been even better. Mr Kirkland then observed:

20 *Proof Committee Hansard*, 22 May 2014, p. 67.

21 *Proof Committee Hansard*, 22 May 2014, p. 55.

22 *Proof Committee Hansard*, 22 May 2014, p. 66.

23 *Submission 10*, p. 5.

24 *Submission 7*, p. 5.

> So to imagine further compromises as a result of some of the current proposals is something that concerns us greatly and is of great concern to the consumers who have contact with us.[25]

2.20 Dr Marina Nehme, Faculty of Law, University of New South Wales, was of the view that the balance between the protection of consumers and the protection of business appeared to have 'shifted toward the interest of businesses'.[26]

2.21 Other submitters had a different interpretation and were concerned that insufficient weight had been given to the costs and practicalities of implementing the FOFA reforms. Those supporting the proposed changes were of the view that readjustments were needed to remove inefficient, unnecessary or ineffective provisions that either would make access to financial advice more expensive through compliance costs or were in practicable ways unworkable. For example, while Minter Ellison Lawyers supported the objectives of the FOFA legislation to promote a professional financial advice sector, they were concerned about certain aspects of the current legislation. In their opinion parts of FOFA were inconsistent with the goal of ensuring 'an efficient, fair and innovative financial sector'. According to Minter Ellison Lawyers:

> Another critical but often overlooked goal of FOFA was 'to provide access to and [expand] affordability of financial advice'.[27]

2.22 They were of the view that the proposed reforms would help ensure that the FOFA legislation realised these goals. The FSC also recognised the need for further reforms to FOFA. It believed that the proposed changes would achieve that right balance by ensuring that consumers would 'be able to access affordable quality financial advice while at the same time maintaining a strong level of consumer protection'.[28]

2.23 The Association of Independent Owned Financial Professionals also supported the original objectives of FOFA to eliminate conflicts of interest and provide greater protection for consumers. It contended, however, that the previous government went too far with some aspects and endorsed changes 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.[29] In its view:

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25 *Proof Committee Hansard*, 22 May 2014, p. 11.

26 *Submission 8*, p. 5.

27 *Submission 18*, p. 1.

28 *Submission 27*, p. 21.

29 *Submission 26*, p. 1.

> …these changes will not only simplify the industry for its stakeholders but deliver considerable cost savings to all participants including consumers.

2.24 The Australian Bankers' Association on behalf of the banking industry was 'seeking amendments to make sure the law operates as intended and does not adversely impact on retail banking and to make sure bank customers can continue to conduct their banking in ways they want and expect'.[30]

2.25 It should be noted that the submitters, who tended to support the bill in broad terms, did not necessarily agree with all the changes.

Conclusion

2.26 The committee is cognisant of the need, when considering the proposed changes, to strike the right balance between protecting consumers and relieving the burden imposed on the financial service sector, thereby ensuring the availability, accessibility and affordability of high-quality financial advice.[31] In the following chapters the committee examines the main changes proposed to FOFA in this context of finding the right balance between amending existing provisions and ensuring that the new ones are in the consumers' best interests and deliver positive results for the industry. The committee's focus is not only on the immediate costs and benefits to consumers and providers alike but on the long-terms gains for both. It is particularly concerned with ensuring that the changes result in Australian retail clients having access to good quality information and affordable advice about financial products.

30 *Submission 25*, p. 1.

31 See in particular, *Submissions 8* and *11*.

Chapter 3

Best interests duty

3.1 Under Division 2 of Part 7.7A of the Corporations Act, financial advisers providing personal advice to retail clients must comply with the 'best interests duty' and related obligations, which were introduced as part of the FOFA reform package. As noted earlier this reform measure was to improve the quality of financial advice received by retail clients. When introducing the original FOFA reforms, the then Minister for Financial Services and Superannuation stated:

> The best interests duty is a legislative requirement to ensure the processes and motivations of financial advisers are focused on what is best for their clients.[1]

3.2 In this chapter, the committee examines the proposal to remove paragraph 961B(2)(g), known as the 'catch-all' provision, from the list of steps providers may take in order to satisfy the best interests obligation.

Section 961B—provider must act in the best interests of the client

3.3 CPA Australia and the Institute of Chartered Accountants Australia noted that the majority of financial planners provide quality financial advice that is in the best interests of their client. The introduction of the statutory 'best interests' obligation, has 'embedded this obligation in the financial advice framework'. According to CPA Australia and the Institute of Chartered Accountants, the statutory best interests obligation:

> …ensures providers of financial advice make certain the interests of their clients remain paramount, above and beyond those of the adviser, licensee and any relevant associates.[2]

3.4 According to Mr Paul Drum, CPA Australia, the best interests duty is the 'cornerstone of the FOFA reforms', with 'the ability to drive a cultural change within the financial services industry'.[3]

Removal of paragraph 961B(2)(g) known as the 'catch-all' provision

3.5 Subsection 961B(1) of the Corporations Act imposes a general obligation on providers to act in the best interests of the client.[4] This general obligation is

1 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, p. 57.

2 *Submission 14*, p. 3.

3 *Proof Committee Hansard*, 22 May 2014, p. 29.

4 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

supplemented by a provision setting out steps that, if the provider can prove he/she has taken, 'will be taken to satisfy the general obligation'.[5] The 2011 Explanatory Memorandum noted:

> These steps have been set out based on the specific conditions under which advisers currently operate. This approach is needed given the broad nature of a best interests obligation; it may allow a provider to demonstrate that it has complied with the obligation by proving it took certain steps.[6]

3.6 Subsection 961B(2) records the seven steps that a provider 'may prove they have taken to demonstrate that they were acting in the best interest of the client'.[7] It guides financial advisers on the measures they should complete to ensure that they are acting in the best interest of their clients when providing advice. ASIC refers to these measures as a 'safe harbour' for complying with the best interests duty in subsection 961B(1). It advises that showing that 'all of the elements in subsection 961B(2) have been met is one way for an advice provider to satisfy the duty in subsection 961B(1)'.[8]

3.7 The 2011 Explanatory Memorandum states that the steps set out in subsection 961B(2) were not intended to be 'an exhaustive and mechanical checklist of what it is to act in the best interest of the client'.[9] It noted:

> A provider may be able to demonstrate that it has, in fact, acted in the best interests of the client under subsection (1), without having recourse to subsection (2). However, as a general principle of statutory interpretation, it is expected that the interpretation of the general obligation in subsection (1) will be informed by the steps set out in subsection (2).[10]

3.8 The steps are intended to provide an indication of what, as a minimum, is expected of providers in order to be considered to have acted in the best interests of their client.[11] There are seven steps, the last of which is paragraph (g), also known as the 'catch-all' provision. Section 961B currently reads:

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5 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

6 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.21.

7 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.23.

8 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, p. 65.

9 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

10 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

11 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.25.

(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.

Note: 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.

3.9 The bill intends to remove the last step described in paragraph (g) which requires the provider to show 'they have taken any other step (in addition to the six preceding ones) that would reasonably be regarded as being in the best interest of the client'.[12] The proposed legislation also removes section 961E, as a related

12 Item 10 repeals paragraph 961B(2)(g).

consequential amendment. This section specifies what would reasonably be regarded as being in the best interests of the client and currently reads:

> 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.

Opposition to changes to best interests obligations

3.10 A number of submitters strongly opposed the removal of paragraph 961B(2)(g) and consequential provisions. For example, Dr Paul O'Shea, consultant for National Seniors Australia, cited the intention of the legislation, which was to raise the bar, to make the obligation better and more substantial than it was pre-FOFA. But, in his opinion, removing paragraph (g), the only one in 961B(2) which refers to best interests, would 'take us back almost exactly' to the pre-FOFA position.[13] National Seniors argued that the proposed amendment would reduce the advisers' responsibility to act in the best interests of the clients and allow advisers to hide behind a tick box exercise of a limited list of actions.[14]

3.11 Dr Marina Nehme contended that the current steps outlined in section 961B(2) were essential and 'do not add an unreasonable burden on the industry'. She explained further:

> Section 961B(2)(g) is important as it acknowledges that 'one size does not fit all': the advice needed by a client may vary from one situation to the next and as such the steps that may be taken by the adviser to ensure that the advice is for the best interest of the client may be different. Further, the language of the paragraph makes clear that the relevant steps that may be taken are to be determined when the advice is provided and not in hindsight.[15]

3.12 Dr Nehme also referred to the importance of section 961E, which, in her view, provided the necessary clarification for paragraph 961B(2)(g) and as such should not be repealed. She argued that section 961E ensures that the best interests consideration under paragraph 961B(2)(g) was 'assessed objectively and accordingly does not impose an unreasonable burden on the industry'.[16]

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13 *Proof Committee Hansard*, 22 May 2014, p. 68.

14 *Submission 24*, p. 7.

15 *Submission 8*, p. 4.

16 *Submission 8*, p. 4.

3.13 Professor Paul Latimer expressed concern that 'some in the financial services industry have attacked the "catch-all" duty in s 961B(2)(g) before and now after its commencement on the grounds that it makes the best interests checklist in s 961B uncertain'. He rejected their argument that the catch all would create difficulties for advice providers 'to fulfil the best interests test, and that it would be impossible for them to design efficient processes for compliance and for providing advice (ie to tick the box)'. According to Professor Latimer, compliance with the checklist in section 961B(2) by box ticking:

> …potentially takes away the responsibility of advice providers to exercise their own judgment, with the danger that s 961B(2) could be seen as no more than a safe harbour for formal compliance by box ticking. This highlights the importance of the catchall in s 961(2)(g) to keep the box open for professional and independent judgment.[17]

3.14 He noted further the reservations held by some in the financial services industry that the open-endedness of this catch-all provision would create legal uncertainty that would make 'the checklist/safe harbour in section 961B(2) unworkable for advice providers'. According to Professor Latimer, some in the industry argued that advice providers who have followed the checklist may not have confidence that they have discharged their statutory best interests obligations. In response to this contention, he stressed that the open-ended paragraph 961B(2)(g) was 'exactly what the "any other step" is supposed to do'—'it removes a static and inflexible advice model (box ticking) that may fail to take full account of all of the client's relevant circumstances'.[18]

3.15 The ACTU also supported the retention of paragraph 961B(2)(g). It questioned the veracity of the statement in the Explanatory Memorandum, which noted the 'significant legal uncertainty' around how the best interests duty could be satisfied. The Explanatory Memorandum suggested further that without paragraph 961B(2)(g) the remaining safe harbour provisions set 'a high standard for providers to show they have acted in the best interests of their client'. According to the ACTU, both arguments were 'deeply flawed'.[19] The ACTU stated that the Explanatory Memorandum offers no evidence that 'significant legal uncertainty' exists. Indeed, it noted that the new 'catch-all' provision was introduced in 2013 and a number of professional associations have issued advice to their members about how to meet the new obligation. It argued that parts (a) to (f) of subsection 961B(2) comprise:

> …a series of process-related steps that are qualitatively distinct from being required to make the more substantive judgement that assessing a client's best interests demands. The process-related steps that the government

17 *Submission 2*, p. 13.

18 *Submission 2*, p. 13.

19 *Submission 5*, p. 3.

> intends to retain are little more than a codification of what many financial advisers were doing before 1 July 2013.[20]

3.16 In its view, repealing paragraph 961B(2)(g) would remove 'a key safeguard for advice clients'.

3.17 Similarly, CHOICE argued that without paragraph 961B(2)(g), paragraphs 961B(2)(a)–(f) would function as a 'tick-a-box' checklist to assess if the best interests obligation had been met. In its view, the absence of paragraph 961B(2)(g) would leave a test that contains no mention of protecting the client’s best interest.[21] It likewise rejected the contention of those seeking to remove 961B(2)(g) that the provision was too open ended, creating uncertainty as to how advisers could satisfy the obligation.

3.18 CHOICE also cited section 961E, which the bill proposes to remove. This section, as noted previously, defines the best interests of the client as 'any step that a person with a reasonable level of expertise who exercises care and objectively assesses the client’s relevant circumstances would require'. In CHOICE's view, this definition 'addresses the information asymmetry inherent in the client-adviser relationship by linking the best interests obligation to subject matter expertise'. Ms Erin Turner from CHOICE explained:

> People see advisers because they are not experts in the area on which they are seeking advice. What this section in particular did was recognise that 'best interests' is defined as something that someone who is a professional in this area would recognise as being in the best interests of the client [and] is incredibly important.[22]

3.19 COTA was among those who supported retaining the catch-all provision, which in its view, provided 'an important consumer protection as it covers situations which do not neatly fit into the six preceding steps'. It argued:

> If this last step were to be removed the other six steps become a 'tick a box' checklist and weaken the requirement for advisors to reflect in an overall sense on the advice they are giving and whether it would as a whole be considered in the client's best interest. The inclusion of paragraph (g) provides an extra degree of security for consumers that the advisor is acting for them.[23]

3.20 The Governance Institute of Australia recommended that:

> …the proposed amendment to the 'catch-all' provision in s 961B(2) should not proceed in its current form, that is, the amendment to this provision should not repeal the adviser's duty to act in the best interests of the client

20 *Submission 5*, p. 4.

21 *Submission 7*, p. 7.

22 *Proof Committee Hansard*, 22 May 2014, p. 13.

23 *Submission 10*, p. 4.

> but clarify that the onus of proof rests with the person alleging the breach of this section.[24]

3.21 The Australian Institute of Superannuation Trustees (AIST) opposed the removal of the best interests paragraph (g). It maintained that such a move:

> …reduces the adviser's best interests duty to a checklist, by not requiring advisers to take all other reasonable steps. Further to this, the proposed changes remove what would be 'reasonably' in the best interests of clients by removing the 'what would a reasonable adviser do' test at 961E.[25]

3.22 AIST stated further:

> …although we agree and support the intent of the proposed section 961B, we would have preferred that this duty was worded less prescriptively and that a principles-based approach was taken. Section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993*—the obligation for superannuation trustees to act in the best interests of super fund member—illustrates that such an approach is not only possible, but successful.[26]
>
> The removal of 961B(2)(g) has the effect of removing this principles-based approach, with only a checklist of steps remaining. As such, we cannot support its removal. Further, we point out that it is wrong, both in and out of law, to continue to refer to this as a 'duty'.[27]

3.23 Ms Robbie Campo, Industry Super Australia, regarded paragraph 961B(2)(g) as the key consumer protection in the legislation. She stated:

> Its surgical removal will seriously compromise the consumer protection that exists in the best interests duty. Subsection (2) is a stand-alone clause. If you follow the steps in subsection (2), you are deemed to have met the best interests obligations set out in subsection (1). So the steps that are set out are very important.[28]

3.24 According to Ms Campo, subsection (g) was the only one of the seven steps that mentioned acting in the client's best interests. She emphasised that, if you remove that provision, 'none of the other steps make any reference to the client's best interests'.[29]

3.25 It should be noted, however, that when urged to provide instances that could be covered by paragraph 961B(2)(g) but were not included in (a) to (f), witnesses were unable to give such examples. All agreed that subsection 961B(1), which states

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24 *Submission 11*, p. 3.

25 *Submission 22*, p. 6.

26 *Submission 22*, p. 6.

27 *Submission 22*, p. 7.

28 *Proof Committee Hansard*, 22 May 2014, p. 55.

29 *Proof Committee Hansard*, 22 May 2014, p. 55.

clearly that the provider 'must act in the best interests of the client in relation to the advice' was central to the best interests duty.

Support for changes to best interests obligations

3.26 CPA Australia and the Institute of Chartered Accountants Australia noted that the catch-all provision, paragraph 961B(2)(g), and section 961E, created a level of uncertainty given the open-ended nature of the obligation.[30] They were of the view that the current general obligation under subsection 961B(1) combined with the steps that a provider should undertake to satisfy this duty in subsection 961B(2), achieved 'an appropriate balance between a principles-based approach and providing regulatory certainty'.[31] They explained further:

> While we believe that these existing provisions are appropriate, their removal should address any concerns the industry has highlighted. Further, an adviser would still be required to show they have complied with the remaining six steps in s961B(2). This includes identifying the subject matter of the advice being sought by the client (explicitly or implicitly) and the client’s relevant circumstances which would reasonably be considered as relevant to this advice.[32]

3.27 Submitters in firm favour of removing paragraph 961B(2)(g) cited its open-ended nature which, they suggested, created uncertainty and had the propensity to generate ambiguity.[33] They rejected the argument that its removal would weaken the operation of the best interests duty. In their view, the general requirement to act in the best interests of the client in relation to advice and the 'safe harbour' other steps listed in section 961B provided adequate protection for consumers.[34] To their minds, the inclusion of a general catch-all provision upset the balance and essentially rendered the safe harbour not a safe harbour.[35] For example, according to the Insurance Council of Australia, 'the 'catch-all' provision in paragraph 961B(2)(g) created significant legal uncertainty and, because of its open ended nature, made the safe harbour unworkable for financial service providers. As a result, it strongly supported the removal of paragraph 961B(2)(g)'.[36] The Association of Independently Owned Financial Professionals also believed that removing the catch all provision from best interest would be 'a practical approach to a difficult conundrum'.[37]

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30 *Submission 14*, p. 3.

31 *Submission 14*, p. 3.

32 *Submission 14*, p. 3.

33 See for example, Mr Brad Fox, *Proof Committee Hansard*, 22 May 2014, p. 3.

34 *Submission 21*, p. 6.

35 Mr Richard Batten, *Proof Committee Hansard*, 22 May 2014, p. 39.

36 *Submission 9*, p. 2.

37 *Submission 26*, p. 4. Menico Tuck Parrish Financial Services also supported the removal of this catch-all provision.

3.28 Similarly, the Financial Planning Association (FPA) was concerned that the catch-all provisions of the best interests duty (paragraph 961B(2)(g) and section 961E) 'set an unclear and unrealistic expectation for even professional financial planners'.[38] It argued 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 was not clear what was 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.[39]

3.29 With regard to the lack of clarity, the FPA argued that this uncertainty posed 'significant litigation risks for financial planners' that were 'only tenuously connected to a consumer protection benefit'.

3.30 Mr Batten, Minter Ellison Lawyers, informed the committee that the catch-all step in section 961B(2)(g) was not needed to protect consumers and that:

> …the other six steps provide a full, appropriate and complete list of the steps that an adviser would, in all normal courses, need to take to ensure that, in the conduct of obtaining instructions, obtaining information about the clients, the process that they go through to formulate their advice reaches an appropriate conclusion for the client.[40]

3.31 He argued that:

> The best interest duty is about the process of giving advice, and the safe harbour should reflect that. Removing the catch-all step simply removes uncertainty for advisers. It will not affect the duty of advisers to place client interests ahead of their own.[41]

3.32 In his view, the proposed change had the potential to improve consumer outcomes by removing uncertainty and cost for the industry, improving the accessibility and availability of advice.[42] He stated:

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38 *Submission 15*, p. 4.

39 *Submission 15*, p. 4.

40 *Proof Committee Hansard*, 22 May 2014, p. 37.

41 *Proof Committee Hansard*, 22 May 2014, p. 36.

42 *Proof Committee Hansard*, 22 May 2014, p. 37.

> …certainty and clarity are important for consumers and I think it is also important for business. The words 'best interest' will remain in the statute. They will remain in the first subsection of the section to clearly inform consumers, advisers and the courts as to how to approach the safe harbour—the context in which the safe harbour has been made. But I think that repealing the words in what is intended to be a safe harbour, what is intended to be a statement by parliament of how to do something, does not achieve its intended objective.[43]

3.33 The Stockbrokers Association of Australia were confident that the removal of the catch-all from the best interests obligation would not detract from the effectiveness of the best interests duty. In its opinion, the best interests duty in section 961B would remain 'a detailed and robust obligation to ensure that personal advice is suitable for the particular client'. It noted that:

- the catch-all was only one of seven listed obligations in the best interests duty;
- investor protection was strengthened by the obligation to give appropriate advice (section 961G); and
- section 961J remained to ensure that the interests of the client were paramount.[44]

3.34 Accordingly, it disagreed with the view that the removal of the catch-all would somehow remove the best interests duty, or that it would be substantially reduced.[45]

3.35 Mr Brad Fox, Association of Financial Advisers (AFA), noted that several pre-eminent legal experts in financial services law have clearly stated that its removal would not reduce the standard applied to an adviser but would improve the legislation by removing ambiguity.[46] The SMSF Professionals' Association of Australia Limited was concerned that the provision as originally drafted had the potential to be too broad in its application when interpreted by regulators or the courts. It suggested that consequently the legislation:

> …created uncertainty and a high compliance burden for financial advisors. Removing the provision will increase certainty and reduce costs for advisors with these benefits to flow on to consumers of financial advice.[47]
>
> Further, changing the legislative formulation of the best interest duty does not abrogate an advisors fiduciary duty at common law to act in the best interest of their client.[48]

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43 *Proof Committee Hansard*, 22 May 2014, p. 42.

44 *Submission 4*, p. 2.

45 *Submission 4*, p. 2.

46 *Proof Committee Hansard*, 22 May 2014, p. 1.

47 *Submission 21*, p. 6.

48 *Submission 21*, p. 6.

3.36 The SMSF Professionals' Association of Australia also argued that this amendment would 'reduce compliance costs for financial advisers and enhance the ability to deliver scaled advice to consumers who are seeking a limited subset of personal financial advice'.[49] Furthermore, it did not believe that the removal of section 961E would undermine the effectiveness of the best interests duty.[50]

3.37 The Financial Services Council (FSC) noted that subsection 961B(1) establishes the best interests duty, and that there was 'no proposal to amend or repeal the duty requiring financial advisers to act in their client's best interests.[51] By and large, it welcomed the steps set out in subsection 2, which it described as essentially a process, except paragraph 961B(2)(g). In its view, this paragraph left 'the steps open-ended thereby creating ambiguity about what other reasonable conduct/steps the Parliament believed a provider must take in order to comply with the duty'.[52] It stated:

> An advice provider will have significant practical challenges in positively proving, as required by the provisions that the provider had 'taken any other steps that would reasonably be regarded as being in the best interests of the client'. As the obligation involves interpretative professional judgement (post the fact if the matter is taken to court) which reasonable minds may differ in their interpretation.[53]

3.38 FSC obtained legal advice from Mr Ian Jackman SC and Mr Gregory Drew, which stated that the proposed amendments 'would not materially reduce the protective efficacy of the best interests obligation'.[54] It would, however, neutralise

> …the practical difficulties that a provider may otherwise have in positively proving that he or she had 'taken any other step that would reasonably be regarded as being in the best interests of the client'.[55]

3.39 Mr Kevin Tee, Treasury, explained that the intention behind (g) was 'to ensure that the section was flexible' while still trying to achieve the objectives of the best interests obligations. According to Mr Tee, however, the feedback had been very clear—rather than flexibility, it had caused uncertainty. He stated:

> Stakeholders have been telling us that they are not sure what they need to do to show that they have actually satisfied the best interest duty. Instead of really being seven steps there are really like an infinite number of steps

49 *Submission 21*, p. 1.

50 *Submission 21*, p. 6.

51 *Submission 27*, p. 23.

52 *Submission 27*, p. 23.

53 *Submission 27*, p. 24.

54 *Submission 27*, p. 25.

55 *Submission 27*, p. 26.

> because under almost any circumstance you could say, 'Well, you could've done this, this or this.'[56]

Other best interests obligations

3.40 A number of submitters looked more broadly beyond subsection 961B(2) to contend that other provisions in the Act afforded adequate consumer protection. As noted above, the Stockbrokers Association of Australia cited sections 961G and 961J. These two key provisions reinforce the statutory obligation on advisers. In this regard, ASIC advised:

> …the best interests duty in s961B, the appropriate advice requirement in s961G and the conflicts priority rule in s961J are separate obligations that operate alongside each other and apply every time personal advice is provided.[57]

3.41 Section 961G requires that 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.[58] Section 961J places an obligation on the provider to give priority to the client's interests when the provider knows or reasonably ought to know that there is a conflict between the client's interests and those of the provider or other parties such as an associate of the provider or a financial services licensee of whom the provider is a representative.[59]

3.42 With regard to these other provisions, the FPA was firm in its view that removing the provisions would not water down the consumer protections of the FOFA regime and that:

- financial advice must still be in the client’s best interest (section 961B);
- appropriate for the client (section 961G);
- the financial planner must still prioritise the client’s interests (section 961J) ahead of their own; and[60]

56 *Proof Committee Hansard*, 22 May 2014, p. 96.

57 ASIC, Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*, October 2013, paragraph RG 175.214.

58 While this requirement to give appropriate advice remains unamended, the second part of this section is amended which is discussed later in the report.

59 Section 961J lists all the other parties which in addition to those given above include an associate of a financial services licensee of whom the provider is a representative; or 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 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.

60 *Submission 15*, p. 4.

- professional judgement is required as one of the steps of the best interest duty (961B(2)(f).

3.43 According to the FPA, paragraph 961B(2)(f) requires the financial planner to base all judgements they make in advising the client on the client's relevant circumstances, which includes judgement about the scope of the advice, the enquiries they make, the strategies and products they recommend.[61]

3.44 Mr Brad Fox, AFA, agreed that the amendments to the best interests obligations provisions would not undermine, water down or dilute and certainly would not remove the best interests duty. He supported the view that the best interest duty was 'a combined duty listed across a number of references within the law'.[62] He stated further that the association had:

> …asked publicly and privately for anybody to give us an example of what is not covered in (a) to (f) that would be in (g). Nobody has been able to give us an example. So we do not see how (g) helps the law. In fact, the opinions of the legal counsel that we have received is that having (g) does not increase the duty on the adviser at all. What it does have the propensity to do is increase the ambiguity for those interpreting the law. That plays out in two ways. One is obviously in the courts. The second is in external dispute resolution or FOS [Financial Ombudsman Service) settings where FOS might be trying to decide, 'What was intended by (g)?' and trying to develop circumstances that were never there and never designed to be there.[63]

3.45 The association was also concerned about the potential for professional indemnity prices to rise as well, which would make the provision of advice more expensive and unworkable.[64] It should be noted that Mr Alan Kirkland, CHOICE, was not sure that to date there had been evidence of an increase in indemnity insurance premiums as a result of the current provisions.[65]

3.46 Minter Ellison Lawyers also relied on other provisions in the Act to argue that the best interests obligations would not be weakened by the removal of the catch all step.[66] Mr Batten, Minter Ellison, explained that the duties imposed in Division 2 have three elements, the first being the client priority rule; the second being an appropriateness test; and the third being what is known as the best interests duty.[67]

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61 *Submission 15*, p. 4.

62 *Proof Committee Hansard*, 22 May 2014, p. 2.

63 *Proof Committee Hansard*, 22 May 2014, p. 3.

64 Mr Michael Nowak, *Proof Committee Hansard*, 22 May 2014, p. 3.

65 *Proof Committee Hansard*, 22 May 2014, p. 14.

66 *Submission 18*, p. 2.

67 *Proof Committee Hansard*, 22 May 2014, pp. 37–38.

3.47 In Minter Ellison's view, the most important duty was the requirement in section 96lJ for advisers to give priority to client interests when giving advice. Minter Ellison explained that this client priority rule was the essential element of a fiduciary duty, which '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'.[68] The law firm stated:

> 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.[69]

3.48 According to Minter Ellison, section 961E requires advisers to ensure that they only provide advice to the client if it would be reasonable to conclude that the advice was appropriate to the client. Accordingly, advisers must therefore determine that the advice given to clients is appropriate for those clients.[70]

3.49 Finally, Minter Ellison argued that section 961B(l)—the obligation to act in the best interests of the client in relation to the advice—was 'only ever intended to address the process of providing advice'. The 2011 Explanatory Memorandum made this intention clear:

> 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.[71]

3.50 Minter Ellison reasoned that the steps in section 961B(2) were designed to set out the steps that would satisfy the general obligation in section 961B(1) to ensure that client interests were given priority 'when going through the process of providing advice'. It argued:

> It can be seen from these references that, despite being the first mentioned duty in Division 2 of Part 7.7 A, 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.[72]

3.51 In giving oral evidence, Mr Batten underlined the argument that the key or fundamental or even paramount duty was encapsulated in section 961J, which, in his

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68 *Submission 18*, p. 2.

69 *Submission 18*, p. 2.

70 *Submission 18*, p. 2.

71 Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.22.

72 *Submission 18*, p. 3.

words, 'expresses the fundamental essence of the nature of a fiduciary relationship'.[73] Mr Batten stated:

> That is the duty that requires advisers to place client interest first. The origin of FOFA, and this part of FOFA in particular, is about, as we understand it, ensuring that financial advisers giving personal advice owe a fiduciary duty to clients. Obviously as legal practitioners fiduciary duty is familiar to us in an advice-giving context. In our view, we would see the obligation to put client interest first as the primary obligation in that regard.[74]

3.52 The Financial Services Council also underlined the interconnectedness of other provisions in the Corporations Act and the law more broadly, stressing the importance of noting that the best interest duty was not a singular duty. It explained:

> Whilst the steps in section 961B(2) are largely congruent with, they are additional to, the duty an adviser owes their client under general law fiduciary obligations (profit and conflict rules) and under contract law (and torts). As such advisers will operate under a number of, each slightly nuanced, disparate legal 'best interest' obligations which adds to the complexity and cost of the regime.[75]

3.53 In their legal advice, Mr Ian Jackman SC and Mr Gregory Drew highlighted the paramount obligation imposed by section 961J:

> For completeness, our advice notes that the best interests obligation must be read subject to other continuing provisions which expressly require that the provider must only provide advice that is appropriate to the client (s 961G) and that insofar as any conflicts of interest may arise, the provider must give priority to the client's interests when giving the advice (s 961J).[76]

3.54 Aside from subsections 961B(1) and 961B(2), the FSC also referred to the requirements to:

- give appropriate advice (section 961G), including continuing to comply with 'know your client' and 'know your product';
- warn the client if the advice is incomplete or based on inaccurate information (section 961H); and
- prioritise the interests of the client.[77]

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73 *Proof Committee Hansard*, 22 May 2014, p. 39.

74 *Proof Committee Hansard*, 22 May 2014, p. 37.

75 *Submission 27*, p. 24.

76 *Submission 27*, p. 26.

77 *Submission 27*, p. 17.

3.55 As noted above, the FSC cited section 961H as another requirement intended to protect consumer interests. This section requires an advice provider to warn the client where personal advice is based on incomplete or inaccurate information.[78]

3.56 In concluding its argument, the council observed that the government's proposed changes only amend two of the steps in section 961B(2) and 'do not repeal or amend any of the other significant consumer protection mechanisms built into the new legislative framework'.[79]

3.57 In the view of the FSC, supported by a number of other submitters, the combination of all the measures makes up the best interests and related duties and 'provide significant bolstering to consumer protection mechanisms in the law'.[80] It should be noted that ASIC, in its regulatory guide, also noted that an AFS licensee has a specific obligation to take reasonable steps to ensure that its representatives comply with the best interests duty, citing not only section 961B but:

> …appropriate advice requirement (s961G), obligation to warn the client if advice is based on incomplete or inaccurate information (s961H), and obligation to prioritise the interests of the client (s961J).[81]

3.58 The FSC had other concerns about the best interests duty. It noted that in addition to the ambiguity in the legislation discussed above, it had submitted previously that the term 'best interests' appears in other legislative contexts. It referred to subsection 52(2)(b) of the SIS Act and section 181 of the Corporations Act. It its view, there remained 'the potential for some degree of confusion or for incorrect assumptions to be made regarding its meaning in this context'. Alternatively, the courts may interpret the duty based on the outcomes of the advice process that is as a 'best advice' obligation, which is not only an impossible and unreasonable test for an adviser to defend but also contrary to the previous government's stated policy that:

> …the focus of the duty should be on how a person has acted in providing advice rather than the outcome of that action.[82]

3.59 According to the FSC, the Explanatory Memorandum also implies that compliance with the best interest obligations is measured through an outcomes test by inclusion of the wording 'better position'. It noted that the Explanatory Memorandum states:

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78 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission October 2013, p. 8.

79 *Submission 27*, p. 24.

80 *Submission 27*, p. 24.

81 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission October 2013, p. 13.

82 Future of Financial Advice, Information Pack, 28 April 2011, p. 12, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 24 April 2014).

> …when determining the appropriateness of advice, an adviser must consider whether the advice provided could reasonably be expected to leave the client in a better position given their relevant circumstances.[83]

3.60 The FSC was strongly of the view that the best interests duty must be a conduct duty and not an outcome duty (tested on the outcomes of the advice).[84] As noted above, the previous government had made this point clear:

> The government recognises that the focus of the duty should be on how a person has acted in providing the advice rather than the outcome of that action.[85]

3.61 Accordingly, the FSC recommended that the reference to 'better position' in the Explanatory Memorandum be removed or amended to reflect the stated policy.[86] The committee agrees with this suggestion.

Conclusion

3.62 The committee has taken into account the arguments in favour of retaining paragraph 961B(2)(g)—the catch-all provision and those advocating its removal. It understands the necessity to ensure that consumer protection provisions are not undermined by the proposed amendments. It equally understands that the open-ended nature of paragraph 961B(2)(g) generates uncertainty and ambiguity about what the provider is supposed to do. Moreover, the committee is persuaded by the evidence relying on the consumer protections provisions, including sections 961G, J and H and the best interests requirement in subsection 961B(1), that the removal of the catch-all provision would not dilute the best interest duty.

3.63 Specifically, an AFS licensee has a specific obligation to take reasonable steps to ensure that its representatives comply with the best interests duty (section 961B), appropriate advice requirement (section 961G), obligation to warn the client if advice is based on incomplete or inaccurate information (section 961H), and obligation to prioritise the interests of the client (section 961J).[87] Indeed, the committee is of the view that all of these provisions work together to ensure that, if this amendment goes ahead, there would be no dilution of the best interests duty, but a greater deal of certainty for both client and adviser.

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83 *Submission 27*, p. 5.

84 *Submission 27*, p. 25.

85 *Submission 27*, p. 25 and Future of Financial Advice, Information Pack, 28 April 2011, p. 12, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf (accessed 24 April 2014).

86 *Submission 27*, p. 25.

87 Regulatory Guide 175: *Licensing: Financial product advisers—Conduct and disclosure*, Australian Securities and Investments Commission, October 2013, p. 13.

Chapter 4

Scaled advice

4.1 A key objective of the FOFA reforms was to facilitate access for retail clients to financial product advice, including 'scaled' advice; that is, personal advice that is limited in scope.[1] The Explanatory Memorandum notes that while the Corporations Act does not contain a definition of scaled advice, it is usually referred to in the industry as a 'targeted form of personal advice'.

4.2 ASIC research has shown that many Australian consumers would like more information and advice about investment issues and that a third of Australians were 'expressing a preference for piece-by-piece advice rather than holistic or comprehensive advice'.[2] When introducing the FOFA reforms, the previous government spoke of the need for limited advice:

> The Government is taking further steps to ensure that financial advice will be within the reach of a wider range of Australians, by facilitating the expansion of a new form of advice called 'scaled advice'.[3]

4.3 In order to facilitate scaled advice, the government amended the existing reasonable basis for advice obligation in the Corporations Act to make it clear that this obligation was commensurate with and scalable to the client's needs when providing advice. It did so as part of the original FOFA reforms. At the time, this measure was intended to help address some concerns identified by industry that the provision of scaled advice was not consistent with their obligations under the Corporations Act.

4.4 In this chapter, the committee considers the proposed changes intended to facilitate better the provision of scaled advice.

Current provisions and proposed changes

4.5 The Explanatory Memorandum to the 2011 bill provided the following reasoning for introducing scaled advice:

> …in some cases, particularly where the client has complex needs or objectives, it is recognised that clients may not be immediately able to identify the subject matter of the advice they are seeking. In these situations, it may be necessary for the provider to enter into a discussion

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1 ASIC, Consultation Paper 18, *Giving information, general advice and scaled advice*, August 2012, p. 7.

2 ASIC, Consultation Paper 18, *Giving information, general advice and scaled advice*, August 2012, p. 7.

3 Future of Financial advice, Information Pack 28 April 2011, p. 13, http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf

> with the client about what subject matter of advice would be in their best interests. This can take into account considerations like how much the client is willing to spend on the advice. However, the provider cannot enter into a contract to be exempted from this obligation merely by seeking formal agreement from the client that the subject matter of the advice that has been given by the provider is what has been requested by the client and is therefore in the client's best interests.
>
> This process is designed to accommodate the provision of limited advice (also referred to as 'scaled advice') that only looks at a specific issue (for example, single issue advice on retirement planning) and 'holistic' advice that looks at all the financial circumstances of the client. In some situations, the client might prefer to receive more targeted advice on a matter that is particularly concerning them rather than comprehensive advice. As long as the provider acts reasonably in this process and bases the decision to narrow the subject matter of the advice on the interests of the client, the provider will not be in breach of their obligation to act in the client's best interests. The scaling of advice by the provider must itself be in the client's best interests, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances.[4]

4.6 Holistic personal advice can often be expensive. Scaled advice, with its limited scope, provides a cheaper option than more fulsome personal advice and hence is 'an affordable avenue for many consumers seeking personal advice'.[5] For example, based on wide consultation with its members over the past four years, the IPA concluded that its members often found it difficult to refer 'mum and dad' clients for financial advice.[6] In the view of the IPA, it was critical for 'competent financial advice' to be available to consumers who are 'not considered high net wealth individuals'. For this reason, it argued 'the cost of providing advice must be reasonable if this sector of the market is to be adequately serviced'.[7]

4.7 ASIC has provided guidance on the provision of scaled advice. It has advised that the inquiries made by advice providers as part of their client fact-finding process can be 'scaled up' or 'scaled down', depending on the nature of the advice being sought.[8] In Regulatory Guide 244, ASIC indicated that advice is provided along a continuous spectrum and that all types of advice can be scaled, including advice about complex issues. It suggested that an advice provider's inquiries would need

4 Replacement Explanatory Memorandum, paragraphs 1.33–1.34.

5 Explanatory Memorandum, paragraph 1.20–1.21.

6 *Submission 16*, p. 4.

7 *Submission 16*, p. 4.

8 ASIC, ASIC, Regulatory Guide, 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG244.58 http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg-244-published-13-December-2012.pdf/$file/rg-244-published-13-December-2012.pdf (accessed 23 April 2014).

to reflect the nature of the matters the provider was considering. According to ASIC, some points an adviser needs to observe when giving scaled advice include:

- the rules that apply to 'scaled advice' and 'comprehensive advice' are identical;
- scaled advice can include advice on a single topic or advice on multiple topics;
- scaled advice is not lesser quality advice;
- scaled advice does not mean that the advice provider who gives the advice can have lower training standards; and
- while processes can be used to help advisers provide scaled advice, they need to use their expertise and skills as an advice provider to deliver good quality scaled advice.[9]

4.8 ASIC also cautioned providers when providing scaled advice to:

> …ensure that you communicate clearly to clients the service you are providing (i.e. information or advice). If you are giving scaled advice, you need to communicate clearly the advice you are providing and the advice you are not providing, and the implications of this.
>
> For example, when giving scaled advice, it should be very clear in your SOA [Statement of Advice] (if you are required to give one) what advice you have provided and what advice you have not provided, the implications of this, and why you have taken this approach.[10]

4.9 In its guidance, ASIC made plain that the same rules apply to all personal advice on a particular topic: that there are not two sets of rules—one for 'comprehensive' advice, and one for 'scaled' advice that is more limited in scope. In this regard, the best interests duty and related obligations apply to all personal advice on a particular topic, regardless of the scope of the advice. ASIC stated quite clearly that scaled advice would 'be unlikely to meet the best interests duty and related obligations if the client does not understand any of the significant limitations or qualifications that apply to it'.[11]

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9 ASIC, ASIC, Regulatory Guide, 244, *Giving information, general advice and scaled advice,* December 2012, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg-244-published-13-December-2012.pdf/$file/rg-244-published-13-December-2012.pdf (accessed 23 April 2014).

10 ASIC, ASIC, Regulatory Guide, 244, *Giving information, general advice and scaled advice,* December 2012, p. 7, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/rg-244-published-13-December-2012.pdf/$file/rg-244-published-13-December-2012.pdf (accessed 23 April 2014).

11 ASIC, Regulatory Guide, 244, *Giving information, general advice and scaled advice,* December 2012, pp 9 and 19.

Purpose of the proposed changes

4.10 According to the Explanatory Memorandum, the bill amends the best interests obligations to facilitate the provision of scaled advice. The intention of the changes to the legislation is to make clear that an advice provider and a client may agree on the scope of advice to be provided. As noted earlier, scaled advice is personal advice where the scope of the advice has been limited. The Explanatory Memorandum advises that providers need only investigate the objectives, financial situation and needs of their client that are relevant to the scaled advice to be provided.[12] According to the Explanatory Memorandum:

> There is currently uncertainty over the amount of work that is required for providers to satisfy their best interests duty when providing scaled advice. There is also uncertainty over the ability for providers and clients to agree on the scope of scaled advice.[13]

4.11 There are two proposed amendments that are of particular relevance to scaled advice—the addition of subsection 961B(4A) and new paragraph 961B(2)(ba).

Subsection 961B(4A)—Client seeks scaled advice

4.12 After subsection 961B(4), the bill inserts subsection (4A) which would allow a client to seek scaled advice.[14] It states:

> To avoid doubt, nothing in this section [that is, provider must act in the best interests of the client] prevents the provider and a client from agreeing the subject matter of the advice sought by the client.

4.13 The bill provides an example of how this adjustment could proceed:

> Example: A client approaches the provider intending to seek advice on a particular subject matter. As a result of discussion with the provider, the client decides to instead seek advice on a narrower subject matter. The provider and the client then agree the subject matter of the advice sought by the client. The obligations of this Division apply to the advice ultimately sought.[15]

4.14 According to Treasury, this change to the legislation was intended to address concerns expressed about the ability to actually provide scaled advice. Treasury informed the committee that some stakeholders indicated that there was not sufficient clarity on what advice would actually be provided.[16] For example, the National

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12 Explanatory Memorandum, p. 9.

13 Explanatory Memorandum, paragraph 1.5.

14 Item 13.

15 Item 13.

16 Mr Kevin Tee, *Proof Committee Hansard*, 22 May 2014, p. 89.

Insurance Brokers Association of Australia informed the committee about its concerns with aspects of the following current requirements:

- providers required to undertake a fulsome investigation into the client's objectives, financial situation and needs before any scaled advice can be provided; and
- uncertainty on whether clients and advisers can agree on the scope of the advice to be provided.[17]

4.15 Subsection 961B(4A) takes into account a situation where clients may go to an adviser but they do not really know what advice they want to obtain.[18] Treasury explained further:

> They may say to the adviser 'Could you give me advice on items A, B and C?'
>
> The adviser says, 'Yeh, okay, but it's going to cost you $5,000 for me to do a plan for that.' The client then says, 'Well, $5,000 is too much. Can I get something less?' Then after a discussion between the adviser and the client they decide, okay, we will just get advice on item B and it will be much cheaper. They are scaling it down to just item B. 'It will be cheaper. You can afford it. Are you content with that?' That is what the change to scaled advice is trying to do.[19]

4.16 As explained in the example attached to (4A), the best interests obligations of Division 2 apply to scaled advice. In this context, the bill also re-orders the safe harbour steps in subsection 961B(2) by repealing paragraph 961B(2)(a), which states that the provider has 'identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions'.

4.17 In its place, the bill inserts new paragraph 961B(2)(ba), which would mean that to satisfy this step in the best interests duty, the provider should be able to prove that he/she has:

> …identified the objectives, financial situation and needs of the client that are disclosed to the provider by the client.

4.18 The Explanatory Memorandum notes that:

> Notwithstanding the fact that the steps in subsection 961B(2) do not need to be followed in the order as written, the position of the new paragraph (after paragraph 961B(2)(b)) should help alleviate concerns that an up-front full fact find is required to be performed ahead of any other steps.[20]

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17 *Submission 3*, p. 5.

18 *Proof Committee Hansard*, 22 May 2014, p. 89.

19 *Proof Committee Hansard*, 22 May 2014, p. 89.

20 Explanatory Memorandum, paragraph 1.38.

4.19 It should be noted that the Explanatory Memorandum to the earlier FOFA bill advised that the principle guiding the application of the best interests obligation was that 'meeting the objectives, financial situation and needs of the client must be the paramount consideration when going through the process of providing advice'.[21]

4.20 The bill also adds a sentence to the end of the note at subsection 961B(2).[22] Currently the note reads:

> 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.

4.21 The proposed additional sentence reads:

> The provider need not inquire into circumstances that would not reasonably be considered as relevant to the subject matter.[23]

4.22 As noted in the previous chapter, the best interests duty operates in conjunction with the appropriate advice requirements set out in section 961G, which requires advice provided to be appropriate had the best interests duty been satisfied. The bill would amend this section to state:

> …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, *having regard to section 961B.* (The italicised section to replace 'had the provider satisfied the duty under section 961B to act in the best interests of the client'.)[24]

4.23 The Explanatory Memorandum underscores the importance of this provision:

> To ensure the appropriateness requirement operates as a separate obligation, the Bill amends section 961G to provide that advisers must only provide advice to the client if it would be reasonable to conclude that the advice is appropriate to the client 'having regard to' section 961B.[25]

Opposition to changes to the provision of scaled advice

4.24 A number of submitters opposed the amendments to the bill designed to facilitate a client and provider agreeing to limited advice.

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21 Replacement Explanatory Memorandum, paragraph 1.22.

22 Item 11.

23 Item 11.

24 Item 15.

25 Explanatory Memorandum paragraph 1.42.

4.25 CHOICE did not object to clients being able to access limited advice but had reservations about the effect of the proposed changes:

> Limited or scoped advice can be an affordable and appropriate option for some clients but the scope of advice must be built on a professional investigation of a client's relevant circumstances. Inadequate investigation of a client's circumstances is highly likely to lead to poor advice.[26]

4.26 In CHOICE's view, the addition of subsection 961B(4A) would allow advisers in effect to 'contract out' of their duties to consumers by bypassing the full best interests obligation in defining the scope of advice. In its view, rather than 'addressing the information asymmetry in the client-adviser relationship, this change would allow the lack of knowledge a consumer has about finance to be exploited'.[27]

4.27 CHOICE also referred to the proposal to repeal paragraph 961B(2)(a) and the insertion of the new safe harbour step (ba).[28] According to CHOICE removing paragraph 961B(2)(a) and replacing it with 961B(2)(ba) reorders the process a financial adviser can take to meet the best interests obligation. It noted that 'specifically, an adviser would be able to investigate a client's circumstances after agreeing on the scope of the advice, which would be extremely disadvantageous to consumers'.[29] CHOICE agreed with ASIC's assessment that 'Even for very limited advice, there were some topics that cannot reasonably be excluded from scope' such as income levels or existing debt.[30]

4.28 Ms Turner, CHOICE, argued that removing (g), removing 961E, amending J and multiple changes to scaled advice renders the best interests duty largely ineffective.[31] Overall, CHOICE warned that should the bill pass in its current form advisers would 'be able to scope advice in a manner that is not in their client's best interest'.[32]

4.29 The Australian Institute of Superannuation Trustees (AIST) was strongly of the view that no changes should be made to accommodate a reduced scope of investigation of a client's circumstances.[33] It could not support the measure, indicating that:

> The removal of 961B(2)(a) would remove the advisers' requirement to ask any questions outside those that are explicitly relevant to the scope of the

26 *Submission 7*, p. 8.

27 *Submission 7*, p. 8.

28 Items **7** and 8 which repeal paragraph 961B(2)(a).

29 *Submission 7*, p. 8.

30 *Submission 7*, p. 8.

31 *Proof Committee Hansard*, 22 May 2014, p. 13.

32 *Submission 7*, p. 8.

33 *Submission 22*, p. 7.

> advice. We consider that such an approach to an adviser's investigation can only lead to an increase in poor advice.[34]

4.30 It referred to the note at paragraph 1.19 of the Explanatory Memorandum, which makes clear that all personal advice is scaled or limited in scope to a degree—that 'advice is either less or more comprehensive in scope along a continuous spectrum'. AIST contended that it had long maintained that, regardless of whether the advice is 'holistic' or 'scaled', 'the same requirements apply to an adviser in terms of paperwork, disclosure and general compliance'.[35]

4.31 AIST gave an example of where, in its view, a client may receive inappropriate advice because of the provisions around scaled advice:

> Archie has recently changed jobs and will be earning significantly more than what he previously earned. He makes an appointment to see Bianca to get advice on salary sacrificing into superannuation. Bianca and Archie agree that, on this occasion, Archie will only require advice on salary sacrificing into superannuation, and Bianca limits her investigation accordingly, before recommending that Archie sacrifice an additional $300 per fortnight into his super fund. However, Bianca's investigation did not and was not required to inquire about Archie's mortgage: Archie bought a house about three years ago, and still has about $300,000 left to pay off. Had Bianca included this in her scope of investigation, she might have potentially considered that the additional contributions to superannuation may not have been in Archie's best interests.[36]

4.32 In AIST's view, such agreements would mean that, in addition to being restricted to collecting information relevant only to the scope of advice, the adviser would not be able to advise on any apparent 'red flag' items that are obtained through this narrowed scope of investigation. Mr Webb, AIST, was particularly concerned about subsection (4A) arguing that if that provision were to go ahead, then 'any kind of scoped advice would be able to circumvent the rest of the provisions of the section'.[37] AIST believes that such arrangements were potentially subject to a variety of manipulation.[38]

4.33 The Governance Institute of Australia noted that if the changes come into force, then 'once an adviser and their client agree upon the scope of the advice it will only have to be 'appropriate', rather than in the client's best interest'. It suggested that

34 *Submission 22*, p. 7.

35 *Submission 22*, p. 8.

36 *Submission 22*, p. 7.

37 *Proof Committee Hansard*, 22 May 2014, p. 53.

38 *Submission 22*, p. 8.

the amendment was 'contrary to ensuring that there remains an intention that any advice, even that limited by agreement, is provided in the client's best interests'.[39]

4.34 A number of submitters considered the provision of scaled advice in the context of the removal of paragraph 961B(2)(g) and section 961E. National Seniors believed that it was essential for advisers when considering scaled advice to be acting in the best interests of their client. Dr Paul O'Shea was of the view that scaled advice would be appropriate if 'the best-interests duty included 961B(2)(g), the catch-all, and 961E, the other "step" definition'. National Seniors argued that the proposed scaled advice amendment together with the repeal of paragraph 961B(2)(g) removes the adviser's obligation and incentive to adhere to the best interests duty. It its view, the proposed amendments significantly compromise the quality of financial advice provided to consumers and would likely result in 'major financial detriment'.[40]

4.35 National Seniors referred to the replacement paragraph 961B(2)(ba), which in its view, would push 'the responsibility back on to consumers'. It suggested that, should the changes come into effect, the process would then 'provide financial advisers with a convenient deferral of responsibility limiting the ability of consumers to claim for their investment losses'. In addition, section 961B(2)(g) currently allows the FOFA legislation not to be overly prescriptive. National Seniors argued that if section 961B(2)(g) were removed, additional steps would be required within the legislation to ensure that all possible actions were taken to ensure that advisers act in the best interests of their clients.[41]

4.36 Worried about the proposed replacement paragraph, National Seniors wanted advisers to be compelled to take into account their clients' individual circumstances when they provided scaled advice. It stated:

> The proposed amendment to remove the obligation on advisers to take into account their client's individual circumstances when they deliver scaled advice shifts the responsibility from the adviser back to consumers to assess scaled advice in the light of their individual circumstances.[42]

4.37 In its view, the amendment ignored the fact that consumers would 'always be the less powerful and less informed party when agreement is formed on the scope of any scaled advice'.[43] While National Seniors accepted that, in the short term, the changes may result in lower up-front cost for scaled advice, it argued, however, that:

> …in the long term, scaled advice whose scope has been agreed to in ignorance and which does not consider all relevant financial information is more likely to result in negative investment outcomes. Consumers would

39 *Submission 11*, p. 3.

40 *Submission 24*, p. 8.

41 *Submission 24*, p. 7.

42 *Submission 24*, p. 7.

43 *Submission 24*, p. 7.

> then pay a very high price for their discounted scaled advice through less than optimal investment returns and potentially significant financial losses.[44]

4.38 COTA also held serious concerns about the practice of providing scaled advice. It believed that many people simply 'do not understand the implications of not obtaining comprehensive advice'. It argued:

> The suggestion that scaled advice could be facilitated by allowing consumers and providers to agree on the scope of such advice assumes there is an equal understanding of the implications of receiving limited advice. This is probably not the case for many people who may accept being provided with scaled advice because it is cheaper or more readily available, rather than because they have made an objective assessment of their need for advice. Some examples of scaled advice underline our concerns, such as a couple agreeing to receive advice on planning for retirement, without reference to any debts, when they had two real estate mortgages.[45]

4.39 Ms Root, COTA, noted that:

> The issue, and our concern, about scaled advice is actually about where the best-interest test sits. We have had different interpretations of this presented to us from a number of places and in our own reading of the legislation. There seems to be a call in the legislation for the best-interest test to be different for scaled advice than for holistic personal advice…[46]

4.40 Even so, COTA accepted that 'ultimately consumers should have the right to choose the type of the advice they are receiving'.[47] It stated further:

> The requirement on the provider to clearly explain to the client the consequences of having scaled rather than holistic, comprehensive advice needs tightening up. It needs to include some measure that indicates the client has understood the information they have been given.[48]

4.41 Ms Root concluded that 'until we have better financial literacy, better professional standards for financial advisers and we start to close the gap in knowledge and power, it is better not to have scaled advice'.[49] Likewise, Ms Campo, Industry Super Australia, expressed doubts about the proposal that would allow adviser and client to agree on the scope of advice. She stated:

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44 *Submission 24*, p. 8.

45 *Submission 10*, p. 4.

46 *Proof Committee Hansard*, 22 May 2014, p. 70.

47 *Submission 10*, p. 4.

48 *Submission 10*, p. 4.

49 *Proof Committee Hansard*, 22 May 2014, p. 71.

> We do not see this as facilitating scaled advice; we see it as facilitating sales advice.[50]

4.42 To support her contention, Ms Compo cited the Explanatory Memorandum where it stated that 'this mechanism would be able to be used by a client and adviser to agree that only the products of a particular provider would be considered in the advice'. She then argued:

> Given the disparity in knowledge between adviser and client, it is our view that the adviser must be responsible for ensuring that the scope of advice is in the client's best interests. We believe that this very important consumer protection would be removed by the addition of 4(A) in the best interests duty. Our view is that such agreement is not even possible in the legislation that existed before the FoFA legislation.[51]

4.43 In this regard, the committee notes the findings of an ASIC shadow shopping survey. Although the scope was limited in some way, ASIC, when reviewing the results, saw some evidence that the scope of advice was inappropriate. It noted that in several instances 'particular topics were excluded from the scope of the advice, to the potential benefit or convenience of the adviser, and to the significant detriment of the client'. As an example, ASIC's research found:

> …some advice providers excluded the consideration of a client's debts from their retirement advice. However, if these debts were significant, retirement advice could not have been properly provided without taking this into consideration. In such a situation, a client might mistakenly think that the advice was comprehensive, and that all of their financial circumstances and needs had been taken into account.[52]

4.44 ASIC outlined that 'even for advice on retirement planning that is very limited in scope, there are some issues that cannot reasonably be excluded from the scope' and provided the following example:

> …it would be difficult for an advice provider to recommend significant extra salary sacrificing to superannuation without some understanding of the client's cash flow and other financial commitments.[53]

4.45 The committee understands the potential that exists for providers, if they do not adhere to the best interests obligations, to provide deficient advice.

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50 *Proof Committee Hansard*, 22 May 2014, p. 55.

51 *Proof Committee Hansard*, 22 May 2014, p. 55.

52 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, paragraph 10, p. 9.

53 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, paragraph 10.

Support for changes to the provision of scaled advice

4.46 The submitters arguing in favour of the proposed changes acknowledged that the provision of scaled advice was an important aspect of the FOFA reforms which would help extend the provision of financial advice to more Australians.[54] For example, in support of scaled advice, Menico Tuck Parrish Financial Services suggested that:

> If we are to make any headway into providing cost effective advice, then scaled advice is at the heart of it. We tend to move to 'full advice' in fear of missing out something that the law says we should address.[55]

4.47 Stockbrokers Association of Australia provided an example of the advantages in being able to obtain scaled advice:

> In traditional stockbroking, clients often seek advice on a limited basis, for example, a brief inquiry as to which stock(s) to buy or sell. Clients don't often require a full financial plan or advice on their entire circumstances or portfolio of investments. We were therefore pleased to see further measures in the proposed reforms to accommodate clients and their limited requirements.[56]

4.48 The association referred to ASIC's research that showed around one-third of Australians prefer scaled or 'piece-by-piece' financial advice rather than comprehensive or 'holistic' advice. In its view, the new provisions would allow greater certainty and the needs of the client would be better met by the adviser and client being able to agree to limit the scope of advice that is sought. It urged the Parliament to pass the new provisions on scaled advice in their entirety.[57]

4.49 While supporting retaining the best interests provision intact, CPA Australia and the Institute of Chartered Accountants acknowledged the concern that the current requirements in subsection 961B(2) could prohibit the provision of scaled advice.[58] It stated that 'enabling the provision of scaled advice is important, as a client may only require, or importantly be able to afford, advice on limited or a single issue'. It understood that the rationale for repealing paragraph 961B(2)(a) was to facilitate an adviser to scale the advice they would provide to a limited or single issue. It noted:

> However, what is relevant to the advice being provided will be determined by the nature of advice, which should not be either intentionally or unintentionally limited by legislation. Further, given the existing obligation to identify the client’s relevant circumstances, we do not believe the

54 See for example, *Submission 21*, p. 7.

55 *Submission 19*, p. [2].

56 *Submission 4*, p. 3.

57 *Submission 4*, p. 3.

58 *Submission 14*, p. 3.

> proposed amendment changes the enquiries an adviser would be required to make to discharge their duty. [59]

4.50 The SMSF Professionals' Association also supported the proposed changes. It argued the removal of the best interests duty catch-all provision as well as section 961E would:

> …help facilitate the provision of scaled advice by removing the uncertainty that these provisions created in regards to understanding a client's relevant circumstances.[60]

4.51 Both Mr Elvy, Institute of Chartered Accountants, and his colleague from CPA, Mr Drum, agreed with the proposition that the act as amended would provide sufficient protection. In their view, the provisions in the act would place an obligation on a financial adviser to make sufficient inquiries to ensure that the advice on scaled advice would be appropriate to that particular client.[61]

4.52 Minter Ellison Lawyers welcomed the proposal to give explicit recognition to the ability of the client to agree on the scope of the advice. In their opinion, the proposed changes would ensure that clients can obtain the advice they require without having to pay for advice they do not want.[62] Mr Batten, Minter Ellison, acknowledged that consumers were 'always at some level going to be disempowered to some extent, and it is important for the legislation to seek to redress the balance in an appropriate way'.[63] Even so, he supported increased availability of personal advice very strongly and hence saw the amendments as a significant improvement which provided important clarification from what currently existed.[64] In his view, one of the reasons to support explicit recognition of scaled advice was its contribution to delivering financial advice in 'the most cost-effective manner for consumers and with improved availability'.[65]

4.53 Mr Batten suggested that the measures to improve and to reduce uncertainty around the provision of scaled advice would assist in enabling providers more effectively to give advice that the consumers actually need.[66] Indeed, he suggested that, possibly, there was further scope to improve the bill.

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59 *Submission 14*, p. 3.

60 *Submission 21*, p. 7.

61 *Proof Committee Hansard*, 22 May 2014, p. 35.

62 *Submission 18*, p. 3.

63 *Proof Committee Hansard*, 22 May 2014, p. 44.

64 *Proof Committee Hansard*, 22 May 2014, p. 41.

65 *Proof Committee Hansard*, 22 May 2014, p. 45.

66 *Proof Committee Hansard*, 22 May 2014, p. 37

4.54 The Governance Institute of Australia also supported the proposal to allow the financial adviser and client to agree on the scope of the advice to be provided. In its opinion, such an approach would reduce red tape for financial advisers, and reduce uncertainty as to what type of advice was to be provided. This measure would also benefit clients by allowing them to ask for specific and targeted information more relevant to their needs, if they required it.[67] It believed, however, that it was essential that the customer clearly understood the scope of the advice provided. Furthermore, that the statement of scope should include both the subject matter and extent to which the advice is general or tailored to the client's specific circumstances.[68]

4.55 The Institute of Public Accountants (IPA) was in favour of removing the catch-all provision from the list of steps. In its view, it was difficult to reconcile the provision of scaled advice with a best interests duty. The institute stated:

> In practical terms, the more holistic seven step process to comply with the best interests duty would require more time and effort to be spent on behalf of the client for work which has not necessarily been approved or requested by the client. This would make the provision of advice more expensive than is necessary and it is unlikely that clients will agree to pay for work which they have not requested. In turn, this would be against the policy objective of FoFA which is to provide affordable and accessible financial advice to consumers. One of the main advantages of the FoFA reforms is to enable scaled advice which makes financial advice more affordable for consumers. Insisting on a 'catch all' in order to satisfy the best interests duty would undermine this policy objective.[69]

4.56 The IPA firmly believed that the best interests obligations would not be diminished by limiting the duty to the scope of advice being provided.[70] It agreed that provision for scaled advice should be explicit in the legislation, with appropriate guidance from ASIC.[71] It explained:

> Further, while the IPA strongly believes in the concept of providing scaled advice, the practical implementation should be monitored by ASIC, industry and the profession (by bodies such as the IPA) to ensure that the policy objectives of consumer protection and the provision of competent, affordable and accessible advice to all consumer sectors, are fulfilled.[72]

4.57 The FSC welcomed the intention to provide greater access to affordable advice for more Australians by amending the best interests duty to enable the subject

67 *Submission 11*, p. 4.

68 *Submission 11*, p. 4.

69 *Submission 16*, p. 3.

70 *Submission 16*, p. 4.

71 *Submission 16*, p. 4.

72 *Submission 16*, p. 4.

matter of the advice to be agreed between the client and the adviser.[73] It argued that 'consumers deserve to have a right to the advice they want and to be clear about the duty their adviser owes them'. It stated furthermore that the financial advice industry must be able to have confidence in the regulatory framework. It argued that the proposed changes would provide the clarity needed to enable clients 'to better select the advice level they desire and to better manage the cost which they will pay for advice'.[74] The FSC explained:

> An ability to legally limit the scope of an adviser's investigations, without limiting nor contracting out their legal 'best interest' duty to their client, will ensure that more Australians are able to access advice. That is, the ability to access more affordable piece by piece advice from a financial adviser legally able to provide it.[75]

4.58 According to FSC, the ability to scope the advice 'does not mean that an adviser will not have a conversation with the client to seek to understand what advice the client is seeking'. It stressed that 'the conversation to arrive at a "meeting of the minds" was critical'. In its view, this meeting of the minds conversation should 'not be required to be a "full fact find" as step 1 of the duty as is currently legislated'. It noted that subparagraph 961B(2)(b)(i) remains unchanged. This step requires the adviser 'to identify what advice the client is seeking whether implicitly or explicitly, which is achieved by having the qualifying conversation with the client'.[76]

4.59 Overall, it believed that the best interests duty consumer protection mechanism would remain intact and not lead to a contracting out of the duty.[77]

4.60 The FPA was in favour of efforts that would improve clarity for financial planners who wish to provide scaled advice. In its view, the additional changes to section 961B were necessary to maintain consumer protection and support the best interests duty.[78] It explained that the key policy objectives in providing a legislative framework for scaled advice were:

- 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;

73 *Submission 27*, p. 26.

74 *Submission 27*, p. 26.

75 *Submission 27*, p. 26.

76 *Submission 27*, p. 27.

77 *Submission 27*, p. 27.

78 *Submission 15*, p. 5.

- facilitating more efficient and targeted forms of personal financial advice for retail clients, in order to improve access and engagement with our financial system.[79]

4.61 In its assessment, the proposed amendments create certainty for financial planners and have the ability to facilitate scaled advice.[80] Mr De Gori, FPA, noted the need for clients to have the opportunity for scaled advice, but only if the best interests duty obligations still existed. In his assessment, the amendments being proposed would not reduce any best interests duty obligation on the provider. He referred to the proposed restructuring of the safe harbour steps from the first step and the second step being alternated and explained:

> Firstly, we think that professional financial planners do not follow the safe harbour steps in a numbered order, as such, but those steps are there designed to help in the advice process. The obligation to actually identify the client's financial situation, needs and objectives is still paramount both in scaled advice and in holistic advice; there is no difference.[81]

4.62 His colleague, Mr Mark Rantall, agreed, noting that there were still requirements for advisers to make appropriate inquiries into the circumstances of the person coming in for that advice.[82]

4.63 The FPA, however, was of the view that the repeal of paragraph 961B(2)(a) and insertion of (2)(ba) were unlikely to have 'any effect'.[83] In this regard, Minter Ellison Lawyers noted that it made more sense for an adviser to identify the subject matter of the advice sought before identifying the client's relevant circumstances. Therefore, they suggested that the re-ordering of the paragraphs was appropriate and for section 96JB(2)(b) to be the first step.[84] They similarly observed, however, that:

> …s 961 B(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 96IB(2)(b)(ii). We submit that s 961B(2)(ba) is therefore unnecessary and could be removed from the Bill.[85]

4.64 The Treasury highlighted the value to clients of being able to access scaled advice. Ms Quinn stated that it was of no assistance to consumers if they cannot access financial advice. So, in her view:

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79 *Submission 15*, p. 5.

80 *Submission 15*, p. 5.

81 *Proof Committee Hansard*, 22 May 2014, p. 23.

82 *Proof Committee Hansard*, 22 May 2014, p. 23.

83 *Submission 15*, p. 5.

84 *Submission 18*, p. 3.

85 *Submission 18*, p. 3.

> If the situation is that they see a financial adviser and ask for options on A, B, C and D and the adviser says, 'Well, that's a large amount of money,' and the person says, 'Well, I can't afford that,' and walks out the door, that is not a good outcome for the consumer. If in fact there was the ability for the adviser to say, 'Based on the information you've provided me and the conversation we've had, the order of priority that you might want to think about these things is D first, C, B A.' Then the consumer can say, 'Well, actually, okay, I'll have that first one, thanks,' as long as there is protections to make sure that that discussion is appropriate and to make sure that they are aware of what it is they are asking as an agreement. That is a better outcome than someone not getting any advice.[86]

4.65 Ms Quinn explained further:

> …the financial adviser has a duty to ensure that the information they provide is appropriate, and they need to have ascertained enough information for that to be reasonably judged to be appropriate. So, in the case of someone coming in and saying, 'I want to know about inheritance', the adviser would not be able to say anything unless they had some kind of conversation…[87]

4.66 The Treasury informed the committee that it was not the intention of the legislation to undermine the best interests duty when a client seeks scaled advice. Mr Kevin Tee gave the following example:

> …if the client is not receiving the advice on items A and C and just gets advice on item B, there needs to be a discussion. The adviser needs to clearly explain, 'Well, I'm giving you advice on item B. I'm not giving you advice on items A and C. There are consequences if you do not get advice on these things as well. You may want to do that at a later time when you can afford it.'[88]

4.67 According to the Treasury officials, the example provided in the Explanatory Memorandum made it clear that best duty obligations applied. Mr Tee referred to the best interests duties found in Division 2 and cited, as discussed in the previous chapter, sections 961G (appropriate advice) and 961J (prioritise the client's interests). He also referred to section 961H which requires the adviser to provide a warning if there were any incomplete or inaccurate information and section 961L which requires the licensee to ensure that their representatives are complying with these sections.

4.68 He explained that while they are separate subsections, they 'work together to ensure that the advice is appropriate'.[89] Ms Quinn reinforced this argument, stating that Treasury understood that 'all the provisions together provide enough protection

86 *Proof Committee Hansard*, 22 May 2014, p. 90.

87 *Proof Committee Hansard*, 22 May 2014, p. 92.

88 *Proof Committee Hansard*, 22 May 2014, p. 89.

89 *Proof Committee Hansard*, 22 May 2014, p. 89.

for consumers such that it has to be appropriate, reasonable advice, and best-interest duty applies'.[90]

Conclusion

4.69 There can be no doubt that the availability of scaled or limited advice is in the interests of consumers, whereby they are able to narrow the scope of advice so that the advice can be targeted to a specific need and hence at a lower fee.

4.70 The committee is particularly cognisant of the concerns raised by some submitters about the low levels of financial literacy and the potential for consumers not to understand fully the consequences of seeking limited advice. It notes the results of ASIC's survey which showed that advisers, although obliged to adhere to the best interests duty, could still fall short in the advice they provided. Even some of those who supported the bill underlined the need for the best interests duty to apply in full for scaled advice. The IPA recommended that ASIC, industry and the profession should monitor the practical implementation. In particular, the committee supports ASIC's shadow shopping surveys.

4.71 A number of witnesses referred to the importance of clients being made fully aware that they were receiving scaled advice and the consequences flowing from this limited advice. The committee believes that advisers, when providing scaled advice, should be under an explicit obligation to explain clearly to their clients what scaled advice entails and its limitations.

Recommendation 1

4.72 The committee recommends that the Explanatory Memorandum include a paragraph that clearly and unambiguously spells out the best interests obligations—961B(1) and (2), 961G, 961J and 961H—and the level of consumer protection they provide.

4.73 The committee recommends that the government consider closely how these separate obligations work together and whether any further strengthening is required to ensure that a provider cannot circumvent these best interests obligations.

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90 *Proof Committee Hansard*, 22 May 2014, p. 92.

Chapter 5

Modified best interests obligations

5.1 In the previous chapter, the committee considered scaled advice, which is a form of personal advice and subject to the best interests obligations. In this chapter, the committee looks at amendments to existing provisions covering advice that is required to satisfy a modified best interests duty.

5.2 Advice providers must act in the best interests of their client. For advice on some products, however, the adviser need not satisfy the full requirements.

Basic banking and general insurance

5.3 FOFA established arrangements for dealing with the provision of advice solely about basic banking products given by an employee or agent of an authorised deposit-taking institution (ADI). The Explanatory Memorandum for the original FOFA bill described these basic banking and general insurance products as 'simple in nature' and 'more widely understood by consumers'.[1] The definition of basic banking captures 'all types of basic deposit products such as transaction accounts, savings accounts, cash management accounts and short term deposits and basic products associated with a credit facility (debit account with an overdraft facility or a mortgage offset account).[2] The Explanatory Memorandum noted:

> This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, a modified best interests obligation more appropriately balances the benefits to consumers with the compliance costs to providers.[3]

5.4 Currently under subsection 961B(3) an agent or employee of an ADI is not required to satisfy all of the safe harbour steps in paragraphs 961B(2) when providing advice on a basic banking product. They are, however, required to observe paragraphs (a) to (c). Thus, when an employee or agent of an Australian ADI provides advice on these products, the provider is deemed to have complied with the best interests duty obligation if they:

- identify the objectives, financial situation and needs of the client (961B(2)(a);
- identify the subject matter of the advice sought by the client and the objectives, financial situation and needs of the client considered relevant to the client (961B(2)(b); and

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1 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.53.

2 Explanatory Memorandum paragraph 3.40.

3 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.53.

- where reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, make reasonable enquires to obtain complete and accurate information (961B(2)(c).[4]

5.5 The proposed changes to subsection 961B(2), already discussed, regarding paragraphs (a) to (c) will affect the modified best interests duty only in so far as paragraphs (b), (ba) and (c) will now apply.

5.6 In addition, ASIC advises that to satisfy the modified best interests duty the provider:

- must comply with the appropriate advice requirement;
- must comply with the obligation to warn the client if advice is based on incomplete or inaccurate information; and
- does not need to comply with the requirement to prioritise the client's interests.[5]

5.7 Subsection 961B(4) provides further that the same obligations apply to a general insurance product.[6] Currently, a modified form of the best interests duty applies when advice is provided:

- on a basic banking product only, and the advice provider is an agent or employee of an Australian authorised deposit-taking institution (ADI), or otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI;
- on a general insurance product only;
- a basic banking product, a general insurance product or a combination of those products, where the advice provider is an agent or employee of an Australian ADI, or otherwise acting by arrangement with an Australian ADI under the name of an Australian ADI; or
- general insurance and other products.[7]

5.8 According to the Explanatory Memorandum, the proposed legislation makes consequential amendments to the modified best interests duty as a result of the inclusion of consumer credit insurance products in section 963D. This change is in accordance with the government's commitment to include consumer credit insurance products in this section of the Corporations Act.

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4 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.50.

5 ASIC, Regulation Impact Statement, *Future of Financial Advice: Best interests duty and related obligations*, December 2012, p. 7.

6 Explanatory Memorandum, paragraph 1.49.

7 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.52.

5.9 The bill repeals subsections 961B(3) and (4) and inserts new subsections that would change the current arrangement and broaden the existing basic banking products to include all simple 'Tier 2' products.[8] Tier 2 products include basic banking products, general insurance products and consumer credit insurance.

5.10 The Explanatory Memorandum makes clear that this amendment:

> …does not extend the modified best interests duty…to the provision of consumer credit insurance; rather, it allows the modified best interests duty to apply to a basic banking product and/or general insurance product where the subject matter of the advice sought also relates to consumer credit insurance.[9]

5.11 Section 961J requires an advice provider to give priority to the interests of the client in situations where the provider knows, or reasonably ought to know, there is a conflict between the interests of the client and the interests of the advice provider. Under subsections 961J(2) and (3) providers of advice about basic banking products or general insurance are excluded from the obligation to give priority to the interests of the client.[10] As noted earlier, basic banking products and general insurance are recognised as being simple in nature and are understood widely by consumers.

5.12 Proposed changes to subsections 961J(2) and (3) would allow an agent or employee to prioritise their own or their employer's interests ahead of the client's for the sale of basic banking products, general insurance, CCI or any combination of those products.[11]

5.13 The bill amends these exemptions from the client priority obligation to align them with the amendments to the modified best interests duty that stem from the inclusion of consumer credit insurance in the basic banking exemption.[12] Thus, as outlined in the Explanatory Memorandum:

> An agent or employee of an ADI will be exempt from the client priority obligation in relation to advice that relates to a basic banking product or a general insurance product, or a combination of these products, if the subject matter of the advice sought by the client relates only to a basic banking product, a general insurance product, a consumer credit insurance product, or a combination of any of these products. The client priority rule will continue to apply to advice provided in relation to a consumer credit insurance product.[13]

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8 Regulation Impact Statement, p. 87.

9 Explanatory Memorandum, paragraph 1.54.

10 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, paragraph 1.63 and Explanatory Memorandum, paragraph 1.58.

11 *Submission 7*, p. 9.

12 Explanatory Memorandum, paragraph 1.56.

13 Explanatory Memorandum, paragraph 1.60.

Opposition to changes to modified best interests obligations

5.14 CHOICE maintained that a reduced best interests obligation is inappropriate for any type of personal advice. It was particularly concerned about changes to CCI, referring to numerous studies that had shown persistent and significant mis-selling.[14] CHOICE recommended no change to the best interests obligation or to scoping of advice.

5.15 Referring to the proposed changes to section 961J, Ms Erin Turner, CHOICE, stated that it:

> …clearly allows situations where when giving advice on basic banking, general insurance and consumer credit insurance alongside of that agents or employees can prioritise their own or, particularly worrying, their employer's interests ahead of a client's.

5.16 She suggested further that, while there was reference to these products being simple to understand, most consumers would not agree. She argued that:

> Even with basic banking products, we find that people have a lot of difficulty understanding not just the short-term but particularly the long-term impacts of taking on a product. With issues of financial literacy, this is very concerning.[15]

5.17 AIST stated that it did not believe that 'a case has been made as to why any financial products should be exempt from the client priority obligation or the full requirements of the best interest obligations'.[16] It stated further:

> In addition, we fail to understand why individual advisers should receive preferential treatment based upon their happenstance of employment with an ADI. [17]

5.18 In its opinion, this provision continued 'to legalise bad advice with respect to these products' and AIST could not support this measure. Furthermore, it believed that to legislate this measure could 'only act to reduce the reputation of financial advisers'.[18]

Support for changes to modified best interests obligations

5.19 The Customer Owned Banking Association (COBA) was of the view that the modified best interests duty, which applies to advice given by banking staff about basic banking products and general insurance products, should also apply to advice on

14 *Submission 7*, p. 9.

15 *Proof Committee Hansard*, 22 May 2014, p. 18.

16 *Submission 22*, p. 8.

17 *Submission 22*, p. 9.

18 *Submission 22*, p. 9.

consumer credit insurance (CCI).[19] It noted that, in its current form, the bill makes banking staff giving personal advice about basic banking products and general insurance products (Tier 2) subject to the modified best interests duty only, even if they also give personal advice about CCI. However, personal advice about CCI itself continues to be subject to the full best interests duty.[20]

5.20 COBA wanted the extension of the modified best interests duty to include CCI. In its view, CCI was 'a relatively straightforward product designed to protect consumers in times of difficulty'. Thus, it argued that bringing 'the best interests duty requirements for advice about CCI into line with those for other Tier 2 products would reduce red tape and ensure consistent regulatory treatment for similar products.[21]

5.21 Ms Diane Tate, Australian Bankers' Association, referred to the basic banking exemptions implemented by the former government that do not work properly and result in a very product-delineated process for retail banks.[22] She cited several amendments considered by the previous government which were to make sure that existing exemptions for basic banking products—deposits, non-cash payment facilities, travellers cheques, general insurance products and consumer credit insurance actually worked in a practical sense. These existing exemptions carve out basic banking products from the full best-interests duty, so that the modified best interests duty would apply, as well as the conflicted remuneration provisions.[23] Ms Tate explained that the banks were not seeking an expansion of those exemptions but rather to have them work seamlessly.[24] She gave the following example:

> …a customer walks into a bank at the moment—and this is a really common scenario—and expresses an interest in a home loan product. A bank teller or a bank specialist can give them some information around that and advice around the types of home loans that are available. The customer then is likely to say, 'I need to make repayments on this home loan; what is the best way to do that?' So then they will start talking about a transaction account, which is a deposit account under the law, and then they might say, 'You know, a good way to minimise your repayments is to have a mortgage offset account.' So suddenly we are now talking about a credit facility and a deposit product.
>
> The next thing is that the customer might say, 'Look, I'm concerned about making these repayments. Are there some products that I can have from a risk management perspective?' That is consumer credit insurance. So now you are having a conversation about that. Then the bank teller may say,

19 *Submission 12*, p. 2.

20 *Submission 12*, p. 2.

21 *Submission 12*, p. 2.

22 *Proof Committee Hansard*, 22 May 2014, p. 75.

23 *Proof Committee Hansard*, 22 May 2014, p. 75.

24 *Proof Committee Hansard*, 22 May 2014, pp. 75–76.

> 'Look, it's also really important to make sure that you have your property insured as well.'[25]

5.22 Ms Tate explained that after 1 July 2014, this seamless set of arrangements could not operate unless the relevant provision in the bill is enacted.

Conclusion

5.23 The committee understands that the current best interests duty impose a modified best interests duty for certain advice providers who provide advice on basic banking products or general insurance products. The amendments to the modified best interests duty are consequential changes stemming from the government's commitment to include consumer credit insurance products in section 963D of the Corporations Act.

5.24 As a consequence of the amendments to the modified best interests duty that flow on from the inclusion of consumer credit insurance in the basic banking exemption, changes to the client priority obligation exemptions were also required.

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25 *Proof Committee Hansard*, 22 May 2014, p. 76.

Chapter 6

Conflicted remuneration

6.1 Since 1 July 2012, under Division 4 of Part 7.7A of the Corporations Act, there has been a ban on conflicted remuneration.[1] Currently, remuneration received in relation to the provision of both personal advice and general advice is captured by the ban on conflicted remuneration. This arrangement reflects the fact that, while it is not in the nature of general advice for the provider to take the kinds of steps envisaged by the best interests duty, the provision of general advice may still be susceptible to influence by conflicted remuneration.[2] Currently, the legislation allows a targeted exemption for general advice from the ban on conflicted remuneration in certain circumstances.

6.2 In this chapter, the committee looks first at personal advice, general advice and commissions and then at the proposed exemptions from the ban on conflicted remuneration.

Conflicted remuneration

6.3 Section 963A provides the following definition of 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.

6.4 The original FOFA legislation recognised that a broad range of benefits 'could be interpreted as possibly influencing advice'. It also appreciated that benefits that would only have a remote influence on advice should not be caught.[3] Thus, the ban on conflicted remuneration does not apply to some areas.[4]

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1 *Submission 1*, p. [3].

2 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.12.

3 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.14.

4 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.8 and Explanatory Memorandum paragraph 3.6.

6.5 Sections 963B and C stipulate the circumstances under which a monetary or non-monetary benefit received by a financial service licensee, or a representative of a financial services licensee, is not conflicted remuneration. As it stands, the Act now imposes a ban on the licensee and their representatives from receiving remuneration that 'could reasonably be expected to influence the financial product advice given to retail clients'. The Act also bans the payment of such remuneration by product issuers or sellers.[5]

6.6 The current bill would amend the Corporations Act to broaden and clarify exemptions from the ban on conflicted remuneration. Specifically, the amendments relate to:

- general advice—providing a targeted general advice exemption from the ban on conflicted remuneration (section 963B);
- execution-only exemption—broadening the execution-only exemption so that it applies where no advice on that product, or the class of products of which the product is one, has been provided to the client by the individual performing the execution service in the previous 12 months (paragraph 963B(1)(c);
- education and training exemption—expanding the education and training exemption to include training relevant to a financial services business (paragraph 963C(c);
- basic banking—broadening the basic banking exemption so that it can be accessed when advice on other simple (Tier 2) financial products is provided at the same time as advice on a basic banking product and/or a general insurance product (section 963D);
- volume-based shelf-space fees—clearly defining volume-based shelf-space fees and the payments the ban on volume-based shelf-space fees intends to capture (subsections 964 (1) and (2) and section 964A);
- client-pays exemption—clarify the operation of the client-pays exemption (note at end of section 963A and 963B(1));
- mixed benefits—clarify the exemptions from the ban on conflicted remuneration to allow a benefit to relate to more than one exemption—that is permitting 'mixing' of benefits in relation to products or circumstances that are exempt from the ban on conflicted remuneration';[6] and
- regulation-making powers—introducing limited regulation-making powers to address future remuneration structures that may be inadvertently captured by the ban on conflicted remuneration.[7]

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5 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice) Bill 2011, paragraph 2.7.

6 Explanatory Memorandum, paragraph 3.16.

7 Explanatory Memorandum, paragraph 3.20.

General advice exemption

6.7 Submitters did not comment specifically on all of the amendments providing an exemption from conflicted remuneration. They did, however, focus particularly on the general advice carve-out.

6.8 As the law now stands, remuneration (both monetary and non-monetary) received in relation to the provision of both personal advice and general advice is captured by the ban on conflicted remuneration. Nonetheless, the legislation allows for exemptions from this ban. Even so, in the government's view the application of the ban on conflicted remuneration imposed 'unnecessary burdens on industry by capturing individuals not directly involved in providing advice to clients'. For example, the Explanatory Memorandum noted that the ban currently:

> …captures employees such as website designers or general information seminar providers who are not in product sales related areas. Industry argue that they are currently required to maintain complex systems when providing general advice to ensure compliance with the existing conflicted remuneration provisions. These systems are costly to implement and maintain.[8]

6.9 In response to consumer and stakeholder concerns about the original amendment being too broad, the government decided to restrict the operation of the carve-out.[9] According to the Explanatory Memorandum, the government has undertaken to provide a 'general advice exemption' from the ban on conflicted remuneration. The proposed exemption would only be available in particular circumstances.[10]

6.10 Although the bill would exempt general advice from conflicted remuneration under certain circumstances, conflicted remuneration on personal advice would continue to be banned.[11] The Explanatory Memorandum noted that the revised general advice exemption would exempt benefits from the definition of conflicted remuneration if the following conditions were satisfied:

- general advice is provided by an employee;
- the employee has not given personal advice to the person receiving the general advice in the past 12 months; and
- general advice is in relation to a product issued or sold by the employer.

6.11 The Explanatory Memorandum noted further:

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8 Explanatory Memorandum, paragraph 5.137.

9 Explanatory Memorandum, paragraph 5.147.

10 Explanatory Memorandum, paragraph 3.4–3.5.

11 Explanatory Memorandum, paragraph 5.135.

> This amendment alleviates the unintended consequences of the original general advice ban without providing too broad an exemption. Website designers, people giving seminars, and other employees who are involved in the preparation of general advice, but who do not provide personal advice, will now be able to utilise the general advice exemption. However, advisers who provide personal advice as well as general advice will not be able to utilise the exemption. As such, this amendment removes the unintended consequences whilst still allowing consumers who receive personal advice to remain confident that their advice is in no way influenced by conflicted remuneration.[12]

6.12 The proposed amendments make a clear distinction between general and personal advice.

Personal and general advice

6.13 Personal advice is financial product advice that takes into account the client's objectives, financial situation and needs. ASIC provides the following guidance:

> Advice may be regarded as personal advice if it is presented in a way that means a reasonable person might expect you to have considered one or more of the client's objectives, financial situation or needs.[13]

6.14 According to ASIC, the test for whether a provider is giving personal advice includes:

- whether the provider is in fact giving financial product advice—that is, whether the provider is making a recommendation about a financial product; and
- whether the provider has considered the client's relevant circumstances in relation to giving or directing the advice, or whether a reasonable person might have expected the provider to do so (section 766B(3)).[14]

6.15 On the other hand, general advice is financial product advice that does not take into account the client's objectives, financial situation and needs. ASIC makes the following distinction:

> General advice about a financial product will not be personal advice if you clarify with the client at the outset that you are giving general advice, and you do not, in fact, take into account the client's objectives, financial situation or needs.[15]

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12 Explanatory Memorandum, paragraph 5.149.

13 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.43.

14 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.35

15 ASIC, Regulatory Guide 244, *Giving information, general advice and scaled advice*, December 2012, paragraph RG 244.43.

Commissions

6.16 Many submitters spoke about the potential for a return of commissions. Indeed, some feared that the exemptions from the ban on conflicted remuneration would re-allow or reopen the door for conflicted forms of remuneration to be paid.[16]

6.17 The Explanatory Memorandum to the original FOFA described a commission as typically 'an arrangement between a product provider and the adviser or the adviser's licensee and is built into a financial product'.[17] FOFA recognised that product commissions:

> …may encourage advisers to sell products rather than give unbiased advice that is focused on serving the interests of the clients. Financial advisers have potentially competing objectives of maximising revenue from product sales and providing professional advice that serves the client's interests.[18]

6.18 As such, FOFA imposed a ban on the receipt of remuneration that could reasonably be expected to influence the financial product advice given to retail clients. There were a limited number of exemptions to the conflicted remuneration provisions and the bill seeks to broaden this carve-out further.

Opposition to broadening exemptions from the ban on conflicted remuneration

6.19 As noted above, a number of submitters saw the proposed amendments as a way of reintroducing the payment of commissions on financial products and wanted no change to the bans on conflicted remuneration. One particular concern was exempting general advice from the ban on conflicted remuneration.

6.20 CPA Australia and the Institute of Chartered Accountants Australia were troubled by the prospect of a return to commissions—a specific payment in return for a specific sale, usually directly from a third party. They were strongly of the view that 'all commissions have the potential for real and perceived conflicts of interest and should therefore be removed'. In their view the proposal:

> …to loosen this ban and permit commissions on general advice not only undermines the principles of the FoFA reforms, they return to encouraging a sales culture in the industry rather than focusing on provision of quality personal advice…Therefore it is imperative that conflicted remuneration structures, especially those usually aligned with sales, are removed.
>
> …

16 See Ms Campo, *Proof Committee Hansard*, 22 May 2014, p. 57 and Ms Storniolo, *Proof Committee Hansard*, 22 May 2014, p. 87.

17 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraph 3.24.

18 Replacement Explanatory Memorandum, Corporations Amendment (Further of Financial Advice Measures) Bill 2011, paragraphs 2.3 and 3.27.

> Despite the fact that general advice does not take into consideration a client's circumstances, the intention remains to influence the sale of a product otherwise there would be little value in remunerating general advice via a conflicted remuneration model.
>
> Further, we are concerned returning to a conflicted remuneration model for general advice may adversely impact the community's perception of the broader financial services industry including those licensed advisers who provide personal advice. Given the very public debate over these reforms, and the number of consumer advocates engaged, this is a very real concern.[19]

6.21 They did not believe that the proposed changes were in the public interest. In their view, the low levels of financial literacy in Australia must be considered, as this factor 'substantially increases the risk that consumers may not be able to differentiate appropriately between general and personal advice'. In their minds, placing this onus on the consumer adds further complexity and uncertainty on those consumers who choose to seek advice.[20] In essence, CPA Australia was of the view that the trouble with commissions was their potential 'to create real and perceived conflicts of interest'. Mr Drum, CPA, and his colleague, Mr Elvy, Institute of Chartered Accountants, argued that remuneration models based on a commission structure do not align with the services generally provided by a professional.[21]

6.22 The Institute of Chartered Accountants would like to see more detail on this matter but would be comfortable with 'a form of incentivisation' if there were a balanced scorecard'.

6.23 To the suggestion that the government's intention was not to bring back commissions, Mr Elvy replied that:

> One of the challenges, looking at the coverage of this reform debate, is: how does a consumer understand the concepts of general advice, personal advice, commissions and so on? There is still a lot of complexity there which we believe needs to be addressed. The concept of commissions with general advice we believe is probably confusing for consumers to understand.[22]

6.24 The concern about the return of commissions was shared by a number of other submitters. National Seniors argued that advisers must be free of any real or perceived bias at all times regardless of what type of advice they were providing to clients.[23] It then spoke of the risks that commissions pose to consumers:

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19 *Submission 14*, p. 6.

20 *Submission 14*, p. 6.

21 *Proof Committee Hansard*, 22 May 2014, pp 29 and 31.

22 *Proof Committee Hansard*, 22 May 2014, p. 32.

23 *Submission 24*, p. 3.

> Commissions by their nature have the ability to influence advisers and create a conflict between advisers providing the most appropriate advice to the client and securing personal financial incentives from commission payments. At their worst, inappropriate arrangements for commissions can lead to the collapses of large companies and result in consumers losing millions of dollars in savings. ASIC indicates that conflicts of interest embedded in financial advice distribution and remuneration, that lead to poor advice, are the heart of this problem.[24]

6.25 It also noted that a larger number of consumers receive general advice as opposed to personal financial advice:

> More and more consumers will receive their investment product information from general rather than personal advice, including advice received directly from the product issuers (which may be provided directly from bank and credit union tellers) bypassing the traditional personal advice provided by financial advice providers.[25]

6.26 National Seniors believed that providing a general exemption on the ban on conflicted remuneration would result in reduced quality of advice provided to consumers, leading to major consumer detriment.[26] It argued that 'consumers and the wider financial market must be protected from the detrimental impact of commissions on all levels of advice'.[27]

6.27 The FPA opposed strongly any possible reintroduction of commissions for financial product advice on superannuation or investment products. It acknowledged that there had been unintended consequences of the FOFA reforms for general advice providers. In its view:

> …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.[28]

6.28 The FPA explained that there were several risks associated with commissions for general advice, which included:

- the conflicted remuneration, which drives business models that encourage a complementary sales model of financial product issuance and distribution, poses a real risk of product mis-selling to retail investors and was rightly banned by the future of financial advice reforms;

24 *Submission 24*, p. 8.

25 *Submission 24*, p. 8.

26 *Submission 24*, p. 8.

27 *Submission 24*, p. 8.

28 *Submission 15*, p. 7.

- commissions incentivise the provision of general advice as a form of consumer education or a replacement for personal advice—general advice is inappropriate for that purpose as it makes it more difficult for consumers to distinguish personal financial advice from marketing material or product sales;
- commission payments have eroded public confidence in our financial system—Australians will not have the confidence in our financial system as long as providers of products or advice are exposed to perverse incentives such as commissions; and
- allowing superannuation investment commissions to be paid on general advice has the potential to shift licensees and representatives away from the provision of personal advice in order to earn commissions.[29]

6.29 Mr Dante De Gori, FPA, sought to clarify his association's approach to remuneration, stating that it would object not only to commissions but to individual incentivisation on a per-product basis.[30] He then went on to explain that they wanted to remove anything that was directly embedded in a product:

> Anything embedded in that product sale that is directly passed on to an individual is therefore a commission.[31]

6.30 Indeed, the FPA had 'no issue with the balanced scorecard approach with incentivisation, normal commercial arrangements that are reasonable in an employee situation—the issue was about embedded product commissions'.[32]

6.31 Mr Rantall, FPA, had concerns about the word 'advice' being used and attached to 'general' advice. Notwithstanding that objection, he was of the view that:

> …if it is general information, people should be getting as much general information as they possibly can, whether it be from their bank or their superannuation fund. We have no issue with that. The issue we have is embedding commissions into product as a form of incentive payment. We also have no issue with reasonable balanced-scorecard-type salary and bonus payments.[33]

6.32 According to Mr Rantall it was:

> unfathomable to think that someone could give general advice—not personal advice but one-off transactional advice that should not be specific to someone's circumstances—and potentially that person could receive an ongoing trailing commission for the rest of the life of that product, where

29 *Submission 15*, p. 6.

30 *Proof Committee Hansard*, 22 May 2014, p. 21.

31 *Proof Committee Hansard*, 22 May 2014, p. 22.

32 Mr Mark Rantall, *Proof Committee Hansard*, 22 May 2014, p. 22.

33 *Proof Committee Hansard*, 22 May 2014, p. 21.

> the client has no control over that commission and cannot turn it off. It is a structural problem.[34]

6.33 Mr Rantall understood that that was not the intention of the proposed legislation. Even so, he stated, we 'still do not think it is the intent of the legislation, but it is the intent of the drafting'.[35]

6.34 In essence, according to Mr Rantall, the real issue was the 'separation of product from advice'. He argued:

> If a commission is a conflicted remuneration then it is conflicted regardless of the business model in which it is paid or the type of advice that is provided to consumers.[36]

6.35 Mr Rowe, FPA, reinforced this message—'if a commission is bad for personal advice it is bad for general advice. If something is evil it is evil'.[37] He went on to state:

> As we sit here today, and I think has been confirmed by Treasury, the drafting still allows for embedded product commissions to be reintroduced. We believe that can be fixed by defining what a commission is and banning it. We encourage the government to move in that direction.[38]

6.36 Thus, while generally in favour of the bill, the FPA could not support the proposed legislation if commissions on general advice remained. In its view, 'As the FOFA reforms were intended to protect consumers from unethical sales practices, the existing legislation creates unintended regulatory overreach.'[39] It recommended that additional amendments be made:

> Sales commissions (both upfront and trailing) should be defined by the Corporations Act and banned with respect to financial product advice on superannuation and investment products.
>
> General advice should no longer be a form of financial product advice, and instead should be re-termed 'factual information' or 'financial product information'.
>
> Financial product information/factual information 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.

34 *Proof Committee Hansard*, 22 May 2014, p. 23.

35 *Proof Committee Hansard*, 22 May 2014, p. 23.

36 *Proof Committee Hansard*, 22 May 2014, p. 20.

37 *Proof Committee Hansard*, 22 May 2014, p. 22.

38 *Proof Committee Hansard*, 22 May 2014, p. 23.

39 *Submission 15*, p. 7.

> Licensing and all the other forms of regulation which currently apply to general advice should apply to financial product information/factual information.
>
> The term Financial planner/adviser should be defined by legislation, in order to prevent individuals who offer financial product information/factual information from representing themselves as financial planners or financial advisers.[40]

6.37 The FPA recommended that the committee engage 'in close consultation with stakeholders on changes to the general advice terminology and definition'.[41]

6.38 Agreeing with FPA's contention, Mr Richard Webb, Australian Institute of Superannuation Trustees, indicated that there was probably room for a category of information that goes out there that certainly is not called 'advice' and is not confused by consumers as being advice.[42] He informed the committee that investors do not know the difference between terms such as information and advice and it was not good enough to suggest that they learn the difference:

> …a lot of financial products are surprisingly more complicated than what people seem to think they are. A lot of the time we talk about basic deposit products as being simple. However, I am not a hundred per cent certain many investors are really familiar with how liquidity works with these products and how if you want an early withdrawal you are going to have to pay an interest adjustment plus a fee.[43]

6.39 In his view, the 'very notion that marginally different types of information should be the basis of different compliance remuneration regimes should be resisted, particularly when investors do not know the difference'. He argued that the opportunity for regulatory arbitrage was too great to ignore.[44]

6.40 The Association of Financial Advisers (AFA) was among the number of submitters very uneasy about the possibility of commissions creeping back as a form of remuneration through the provision of general advice. Mr Brad Fox, AFA, explained:

> When we talk about the accessibility to advice, there are some circumstances where general advice is completely appropriate. If, for example, a client already has a super fund and rings the manufacturer or the owner of that super fund, and let's assume it is a bank, they would expect to be able to get some information about that product—not advice about what

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40 *Submission 15*, p. 7.

41 *Submission 15*, p. 7.

42 *Proof Committee Hansard*, 22 May 2014, p. 53.

43 *Proof Committee Hansard*, 22 May 2014, p. 52.

44 *Proof Committee Hansard*, 22 May 2014, p. 53.

> they should do within that product but advice about the product. For example, what is the administration fee? That is general advice.[45]

6.41 With regard to the exemption of general advice for conflicted remuneration, Mr Fox stated that the whole adviser marketplace has to be very clear on this matter. He was firm in his view that advisers licensed to provide personal advice on tier 1 products, which are the complicated products, should not be able to get commissions for general advice. But he believed that the exemption should go further stating that the AFA did 'not even think that bank tellers, for example, should be able to receive commissions for general advice'. Mr Fox stated that they should be able to be recognised for their job performance, but do not think they should get commissions on general advice.[46] He emphasised this point:

> If someone were in a situation where they were not licensed to provide tier 1 personal advice—and the classic example would be a bank employee, an over-the-counter type situation—we would not want them to be receiving a fee, a percentage, for each individual sale of a product.
>
> But, if you were the client coming in and I was the bank employee and I help you open a new super fund with our bank's product, I do not think I should get $50 for that or one per cent of what you put into it. However, if I were doing a good job overall, and bringing in the balanced scorecard approach, then, yes, I should be able to be recognised for doing a good job…providing personal advice on tier 1 products should not be able to be remunerated for giving general advice.[47]

6.42 In his view, the drafting could be 'improved'. He informed the committee that AFA had been working with other stakeholders about how they might be able to do that and would continue to offer that support.[48]

6.43 According to CHOICE, the proposed additional exemptions would create 'further situations where conflicted remuneration is likely to impact on the quality of financial advice'.[49] CHOICE argued that the changes 'undermine the original FoFA reforms and place consumers at risk'. It did not believe that the protections were adequate. It referred to conditions that would restrict the general advice exemption to employees who had not provided advice to the person receiving the general advice in the past 12 months. In its view:

> The twelve-month rule could be easily circumvented if one staff member provides advice and another sells the product. Additionally, consumers are

45 *Proof Committee Hansard*, 22 May 2014, p. 4.

46 *Proof Committee Hansard*, 22 May 2014, p. 4.

47 *Proof Committee Hansard*, 22 May 2014, pp 4–5.

48 *Proof Committee Hansard*, 22 May 2014, p. 5.

49 *Submission 7*, p. 9.

> still not likely to note a distinction between general and personal advice and may incorrectly believe that the advice provided is appropriate to them.[50]

6.44 Recently conducted research by CHOICE into consumer sentiment on the changes showed that 81 per cent of consumers were concerned that bank tellers would be able to sell complex financial products without assessing their personal needs and that they would earn a commission for doing so.[51] Mr Kirkland, CHOICE, explained that consumers were expected to work out whether they were receiving general advice and understand that there was 'a lower bar and should be more cautious'.[52] In his view, that was completely unrealistic:

> That is one of the things we need to bear in mind when we are looking at things like the changes to conflicted remuneration that are contemplated here. It is just not realistic to expect the consumer to understand that distinction between personal and general advice.[53]

6.45 COTA was similarly concerned about situations where consumers were required to understand whether advice was personal or general. It told the committee that the abolition of conflicted remuneration for personal advice was 'one of the most important components of the package in terms of building trust in the financial planning industry'. It stated that one of its concerns with allowing conflicted remuneration was that:

> …many people do not understand the distinction between personal and general advice and so may be susceptible to strong selling techniques, for example from bank staff. They may purchase products that are not appropriate for them but which they believe 'were recommended by my bank'.[54]

6.46 In its view, the protections outlined in the bill around the type of product and the distinction between provision of personal and general advice were not 'strong enough'. It cited CHOICE's research showing that 81 per cent of consumers were concerned about being sold complex products by bank tellers. COTA found that the feedback it received reflected CHOICE's research results.[55] COTA wanted to see:

> …a robust professional financial advice industry further develop in Australia, in which the regular provision of independent and comprehensive advice becomes the norm not the exception. This is one component of improving financial literacy among people who for the first time, due to compulsory superannuation, will have significant retirement assets but who are not familiar with financial services and products. Allowing conflicted

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50 *Submission 7*, p. 10.

51 *Submission 7*, p. 10.

52 *Proof Committee Hansard*, 22 May 2014, p. 17.

53 *Proof Committee Hansard*, 22 May 2014, p. 17.

54 *Submission 10*, p. 5.

55 *Submission 10*, p. 5.

remuneration for general advice will tend to skew incentives toward the provision of such advice rather than independent, comprehensive, fee based personal advice.[56]

6.47 Ms Campo, Industry Super Australia, referred to what she described as the rhetoric that supported this bill, which talks about the need to ensure that people can access assistance and advice, particularly from bank tellers. In the view of Industry Super, however, the exemption was not really about improved access:

> There is already a complete exemption for basic banking products in the FoFA legislation. Therefore, what we are talking about is allowing commissions and other forms of conflicted remuneration to be paid on complex products, including superannuation but also others like managed investment schemes and leveraged products, which have been the subject of many previous inquiries due to the consumer losses that have ensued.[57]

6.48 Industry Super Australia was also worried that there were no disclosures in the general advice setting to consumers 'to put them on guard that they are not being given impartial general advice, that they are actually being sold something'.[58]

6.49 AIST explained that although the exemption would apply to general financial product advice provided to retail clients, it would apply to all financial products, whether they were relatively simple, such as basic banking products, or considerably complex, such as structured investment products or derivatives.[59]

6.50 The SMSF Professionals' Association of Australia Limited also opposed the amendments to provide a limited exemption from the ban on conflicted remuneration for general advice which is provided in a specific set of circumstances. It was strongly of the view that there was no room for conflicted remuneration in financial services, even where the financial advice being provided does not specifically take into account the consumer's personal circumstances.[60] It stated that remuneration models based on commissions or volume payments were contradictory to a financial adviser providing the best advice for the client, whether they provide personal or general advice. It believed:

> …the best consumer outcomes must be achieved independently from any links with product remuneration. This should be achieved in an environment where remuneration is aligned with providing high quality advice and on a fee for service basis, not on a commission or volume basis

56 *Submission 10*, p. 5.

57 *Proof Committee Hansard*, 22 May 2014, pp 55–56.

58 *Proof Committee Hansard*, 22 May 2014, p. 56.

59 *Submission 22*, p. 12.

60 *Submission 21*, p. 3.

which incentivises sale of products over the provision of objective, quality advice which is in the genuine interest of the client.[61]

6.51 SPAA also referred to the difficulty distinguishing between general and personal advice. It registered its concern that 'a limited exemption for general advice from the ban on conflicted remuneration is complicated by the blurring of the distinction between general and personal advice'. It stated:

> By allowing general advice to receive conflicted remuneration, there is an incentive for advisors and dealer groups to push the limit of this distinction which has been misinterpreted to favour the advisor's position to the detriment of the client. This may have the result of consumers receiving personal advice that is paid for through commission based fees and not subject to the rigours that personal advice must stand up to (i.e. statement of advice and know your client obligations).[62]

6.52 The association made plain that 'increased access to general advice does not equate to consumers receiving financial advice which is appropriate, adequate or will assist them in making improved financial decisions'.[63] It warned that the amendments would result in financial institutions that provide financial products and advice—such as banks and superannuation funds—gravitating towards business models based around general advice. It suggested that this development would be 'at the cost of consumers who seek advice through a major financial institution'. In its views, such consumers would be 'pushed towards general advice which relates to the institution's products rather than receiving advice that addresses their needs'. If these amendments were introduced, SPAA's research suggested that this shift may encourage less engagement by consumers in their financial decisions. According to SPAA, this tendency may have an effect of 'encouraging greater vertical integration in businesses that provide both financial advice and financial products'.[64] It argued:

> Allowing commission based remuneration for general advice in effect lowers the bar that was in place prior to the FoFA amendments and clients are in a worse position in relation to objective advice than they have been in the past. The outcome is a detrimental result for consumers. While the changes in the Bill may lower the cost of general advice in a limited set of circumstances they are likely to lead to an increase in the cost of personal advice.[65]

6.53 In summary, the SPAA believed that the amendments were likely to lead to poorer and more conflicted advice being delivered to consumers and, hence, there was a clear need for a clearer distinction to be made between what is financial advice and

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61 *Submission 21*, p. 3.

62 *Submission 21*, p. 4.

63 *Submission 21*, p. 3.

64 *Submission 21*, p. 4.

65 *Submission 21*, p. 4.

what is factual or sales information.[66] It recommended that the government delay any changes to the ban on conflicted remuneration until after the Financial System Inquiry delivers its report to the Treasurer and has considered alternative approaches to licencing financial advice.[67]

6.54 The Institute of Public Accountants was aware of the controversy around exempting general advice from the ban on conflicted remuneration in certain circumstances. It appreciated both sides to this argument.[68] It stated:

> On the one hand, consumers who have done research and simply wish to purchase a product should be able to do so without having to pay for expensive or unnecessary (holistic) financial advice. This is part of scaled advice or making financial advice more affordable. On the other hand, some consumers may benefit from this advice, even though they may not wish to pay for it. This could lead to consumers purchasing the wrong products or being up-sold or cross-sold products, which arguably defeats the intention of the FoFA reforms.
>
> In addition, giving an exemption to ADIs would provide them with an advantage and create an unlevel playing field. However, extending the exemption could undermine the objective of FoFA of removing the potential for conflicted remuneration.[69]

6.55 The institute was inclined to disagree with the proposed amendment but was of the view that the matter of exemption warranted more discussion and consultation.

Support for broadening exemptions from the ban on conflicted remuneration

6.56 Minter Ellison Lawyers was of the view that product issuers or someone acting on their behalf giving general advice should be excluded from the ban on conflicted remuneration.[70] Mr Batten noted that FOFA's focus had 'always been on ensuring that clients receive advice on their circumstances which is free from any conflict arising from remuneration'. He explained further that the bill would only apply to advice that a client knows is general advice not tailored for them. He suggested:

> Advice will only be general advice where a client could not reasonably think that their circumstances should be considered. So, in other words, if a client thinks they are getting personal advice then basically they are getting personal advice, and that means the prohibition will apply.[71]

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66 *Submission 21*, p. 5.

67 *Submission 21*, p. 6.

68 *Submission 16*, p. 4.

69 *Submission 16*, p. 4.

70 *Submission 18*, p. 3.

71 *Proof Committee Hansard*, 22 May 2014, p. 43.

6.57 Hence, Minter Ellison Lawyers did not believe that remuneration controls were needed for representatives of product issuers when not giving personal advice:

> The issuer will be liable for any misleading or deceptive conduct and will therefore need to ensure that clients do not receive inappropriate general advice. Marketing brochures are an example of where the ban on conflicted remuneration should not apply. It adds costs without any benefit.[72]

6.58 Minter Ellison Lawyers observed that general advice can be given in many different circumstances, such as 'in brochures, on the internet, in correspondence and by call centre and branch staff'. It acknowledged that product issuers were 'naturally and appropriately concerned to promote their products'. In its view, however, there could be no doubt that retail clients expect them to do exactly that: in other words 'the provider's motivation is clear in each case'.

6.59 Thus, according to Minter Ellison, product issuers and their staff would 'have a strong interest in the success of their products however they are remunerated' and therefore there would be no need to regulate their remuneration.[73] They cited a number of key consumer protections that exist 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 104IE and 104IH of the Corporations Act, the requirement to give general advice and advertising warnings in ss 949A and I0I8A 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.[74]

6.60 Taking account of these provisions, Minter Ellison Lawyers submitted that these safeguards provided an appropriate and sufficient level of protection in relation to general advice.[75] They did, however, draw attention to the proposed exemptions in section 963B(6), noting that this exemption was limited to employees of licensed product issuers.[76] They stated:

> 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.[77] It suggested that s 963B(6) should be amended to: also

72 *Proof Committee Hansard*, 22 May 2014, p. 36.

73 *Submission 18*, p. 3.

74 *Submission 18*, p. 4.

75 *Submission 18*, p. 4.

76 Item 29.

77 *Submission 18*, p. 4.

> apply to employees of related bodies corporate of the product issuer; and be extended to agents of the product issuer and others acting under the name of the product issuer. [78]

6.61 FSC supported the amendments that would 'permit remuneration to employees who provide services which, however remote from the consumer, may be deemed today as conflicted remuneration'.[79] It explained:

> That is, the broad definition banning remuneration at section 963A catches within the ban employees who are not providers of advice or are providers of generally available information and general advice 'because of the nature of the benefit or the circumstances in which it is given'. That is, no matter how remote (the employee's work product is from influencing the choice of financial product and/or the advice eventually provided by an advice provider), remuneration including performance bonuses paid to an employee are nonetheless caught and banned by FoFA.[80]

6.62 In its view, this was clearly legislative overreach and highlighted that the balance between consumer protections (banning remuneration to create an advice over a sales culture) had 'swung too far and actually impedes basic information services consumers need'.[81]

6.63 The FSC understands that the intent of the provision in the bill was to enable a business to give general advice to retail clients on its own products, through its employees, and to leave the business free to reward those employees on a performance basis without the constraints of the prohibition on conflicted remuneration.[82] Mr Andrew Bragg, FSC, told the committee that from the council's viewpoint the drafting of the bill needs 'some more work', in terms of ring fencing and being very clear about what that exemption includes and what it does not. As an example, he stated that 'no-one wants to see commissions brought back'.[83] His colleague, Ms Cecilia Storniolo, reinforced this message that the general advice exemption 'requires extra ring fencing to make sure that it is clear that a financial adviser cannot receive those monies': that the proposed legislation does not allow the reintroduction of commissions.[84]

6.64 According to the FSC, the nomenclature in the law today is unhelpful especially with/for consumers. FOFA has not banned all forms of remuneration—but by drafting legislation which calls everything a conflicted payment the perception is

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78 *Submission 18*, p. 4.

79 Item 29.

80 *Submission 27*, p. 28.

81 *Submission 27*, p. 28.

82 *Submission 27*, p. 28.

83 *Proof Committee Hansard*, 22 May 2014, p. 86.

84 *Proof Committee Hansard*, 22 May 2014, p. 87.

created such that even permissible or exempted payments/benefits are perceived to be conflicted. [85] The FSC recommend that consideration be given to rename:

- section 963B—'Monetary benefit given in certain circumstances not conflicted remuneration' as 'Permissible monetary benefits,' and
- section 963C—'Non-monetary benefit given in certain circumstances not conflicted remuneration' as 'Non-monetary benefits'.[86]

6.65 The Stockbrokers Association of Australia was also concerned that the conflicted remuneration provisions originally applied to the provision of both general and personal advice. In its view, extending the scope of FOFA to general advice 'unnecessarily complicated the implementation and administration of the regime' and 'went well beyond the original intention behind FOFA'. From its perspective, the inclusion of general advice in the FOFA provisions made the scope of the prohibition so broad as to make it unworkable. In support of the amendment, it suggested that:

> By definition, **general advice does not take into account a person's needs or objectives** so it is not appropriate to apply a conflicted remuneration regime when a recommendation is not being made based on the person's individual circumstances.[87]

6.66 Ms Diane Tate, Australian Bankers' Association, explained that the banks were endeavouring to make sure that they could continue to provide general advice without having to have convoluted, complex and costly compliance in the background. In her view, such complicated and expensive compliance could prevent banks from being able to provide the freely available information that they do now.[88] She informed the committee that bank staff were not paid commissions but a salary and may have access to a performance bonus based on a balanced scorecard. According to Ms Tate, the banks were:

- not seeking to reintroduce or charge commissions; or
- not trying to gut or dilute the best interests duty.

6.67 In her words, the banks were trying to:

> …get some clarity and simplicity to that so that it does not cut across our attempts to be able to provide more relevant and targeted information—call that 'scaled advice' if you like, but it is personal advice that is relevant to the circumstances of customers.[89]

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85 *Submission 27*, p. 28.

86 *Submission 27*, p. 28.

87 *Submission 4*, p. 2 (emphasis in original).

88 *Proof Committee Hansard*, 22 May 2014, p. 75.

89 *Proof Committee Hansard*, 22 May 2014, p. 75.

6.68 The ABA also underlined the fact that general advice, by its nature, does not take into account an individual's relevant circumstances and must contain a warning to that effect. It may be provided directly via employees and staff or indirectly via brochures or websites (or other electronic interfaces). According to the ABA:

> We consider that the availability of general advice is important for consumers to help them better understand financial products and services, and the options available to them in an affordable manner and through a variety of access channels. This information and general advice is important to lift levels of financial literacy and engagement. It is also important for product issuers to be able to provide information and advice about their own financial products and services. Consumers readily expect this in their customer service interactions with a bank or other product issuer.[90]

6.69 The ABA supported a limited carve out for general advice which aimed to:

- confine the exemption to employees and staff—a person working exclusively under the name or brand of the licensee—and preparing or giving general advice on the financial products of their licensee or a related body corporate of the licensee;
- prohibit the person also providing personal advice on financial products, other than products already exempt, being basic banking products, general insurance products and consumer credit insurance (‘Tier 2 products’); and
- prohibit the person receiving a monetary benefit commonly referred to as an upfront or ongoing commission.[91]

6.70 Ms Meghan Quinn, the Treasury, stated bluntly that the intention was not to have commissions but 'to make sure that not absolutely everybody who is ever answering a question on the telephone is covered by the legislation'.[92] Her colleague, Mr Tee, noted that the Corporations Act mentions commissions a few times but does not actually provide a definition of commission. He added that the matter of commissions was one of the issues that Treasury was working through.[93] Mr Bede Fraser, the Treasury, informed the committee that the government was still open to amendments to achieve the policy intention, particularly 'around the content of allowing commissions'. He stated that the government was 'currently engaging with people to ensure that the general advice provision would not allow the reintroduction of commissions'.[94]

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90 Australian Bankers' Association, *Supplementary Submission*, p. 2.

91 Australian Bankers' Association, *Supplementary Submission*, p. 2.

92 *Proof Committee Hansard*, 22 May 2014, p. 93.

93 *Proof Committee Hansard*, 22 May 2014, p. 94.

94 *Proof Committee Hansard*, 22 May 2014, p. 93.

Conclusion

6.71 Clearly, a number of submitters lodged strong objections to the amendments broadening the exemptions from conflicted remuneration. They came not only from consumer protection groups but from industry groups including CPA Australia and the Institute of Chartered Accountants Australia, FPA, the Australian Institute of Superannuation, AFA, FPSA, and SPAA. The term 'commission' was often used with reference to the original objective of the FOFA reforms, which was to put an end to such practices.

6.72 Those in support of the amendments, however, noted that the current arrangements captured people or circumstances that were never intended to be subjected to the ban on conflicted remuneration. Furthermore, they stressed that the exemption related to general advice only and not personal advice. The bill's intention is to enable a business, under certain circumstances, to give general advice to retail clients on its own products. Even so, the FSC, which supported the amendments, recognised the need 'for more work' to be done on the drafting, which 'requires extra ring fencing' to ensure that the proposed legislation does not allow the reintroduction of commissions'. Indeed, Treasury officials indicated that commissions 'was one of the issues that Treasury was working through'.

6.73 The committee accepts that the current law needs to be changed to remove the unnecessary complications associated with the provision of general advice. In this regard, the committee is concerned about the confusion that surrounds the proposed changes and the fear that they have the potential to reopen the door to commissions. The committee also notes the concerns about the possible misuse or misunderstanding of the term 'general advice'.

6.74 A number of witnesses held the view that the legislation still required more work. The IPA believed that the matter of exemptions 'warranted more discussion and consultation'. The AFA suggested that the drafting could be improved and it was collaborating with stakeholders to see how they could achieve that objective. The FPA noted that while it did not think that the legislation intended to allow the return of commissions, in its view the current drafting provided no such assurance. The FSC referred to the general advice exemption requiring 'extra ring fencing' to make sure that it was clear that an adviser could not receive commissions. The SPAA suggested that the government delay any changes to the ban on conflicted remuneration until after the Financial Systems Inquiry. The Institute of Chartered Accountants would like to see more detail on this matter of exemptions to the ban on conflicted remuneration. Even the Treasury suggested that it was open to amendments.

Recommendation 2

6.75 The committee recommends that the Explanatory Memorandum make clear that it is not the government's intention to reintroduce commissions.

6.76 The committee recommends that the government consider the provisions governing conflicted remuneration and redraft them to ensure that there is greater clarity around their implementation.

6.77 The committee recommends that the government give consideration to the terminology used in the Explanatory Memorandum and legislation (for example, section 766B), such as information, general advice and personal advice, with a view to making the distinction between them much sharper and more applicable in a practical sense when it comes to allowing exemptions from conflicted remuneration.

Chapter 7

Opt-in requirement and fee disclosure

7.1 In this chapter the committee considers two amendments. The first involves removing the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement). The second change involves making the requirement for advisers to provide a fee disclosure statement applicable only to clients who entered into their arrangement after 1 July 2013.

Remove the opt-in requirement

7.2 The opt-in requirement means that financial advisers who have an ongoing fee arrangement with a retail client must obtain their client's agreement at least every two years to continue the ongoing fee arrangement. It applies to new clients who enter into an ongoing fee arrangement from 1 July 2013.[1] The bill would:

- remove the renewal notice obligation for fee recipients; and
- make the requirement for providers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013.

7.3 Under existing legislation, licensees who have an ongoing fee arrangement with a retail client whose ongoing fee arrangement commenced after 1 July 2013 must obtain their client's agreement at least every two years to continue the ongoing fee arrangement (opt-in requirement). If, after receiving the renewal notice, the client decides not to renew or does not respond to the fee recipient's renewal notice, the ongoing fee arrangement terminates.[2] This provision means that the fee recipient is not obligated to provide ongoing financial advice to the client, and the client is not obligated to continue paying the ongoing fee.[3]

7.4 Under the proposed changes, any ongoing fee arrangement continues to exist unless the client or licensee terminates the arrangement. The Explanatory Memorandum notes that under the new law:

> …an 'opt-out' system applies where any ongoing fee arrangement continues to exist unless the arrangement is terminated by either the client or the fee recipient.[4]

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1 *Submission 11*, p. 4.

2 Replacement explanatory memorandum, *Corporations Amendment (Future of Financial Advice) Bill 2011*, paragraph 1.9.

3 Replacement explanatory memorandum, *Corporations Amendment (Future of Financial Advice) Bill 2011*, paragraph 1.9.

4 Explanatory Memorandum 2.20.

7.5 It should be noted that the renewal notice must be sent to the client within 30 days of the end of the two-year period and the client then has 30 days to agree to renew the arrangement.

7.6 The bill repeals sections 962K, 962L, 962M and 962N and subdivision C of Division 3 of Part 7.7A which deal with:

- fee recipient must give renewal notice;
- renewal notice day and renewal period;
- if client notifies fee recipient that client does not wish to renew;
- if client does not notify fee recipient that client wishes to renew; and
- disclosure for arrangements to which Subdivision B does not apply.[5]

Opposition to removing opt-in requirement

7.7 A number of submitters wanted the opt-in provision to remain. They recognised the advantages that such periodic notifications would have for consumers. For example, the ACTU noted that the Explanatory Memorandum does 'not offer or refer to any assessment of the costs involved in implementing the opt-in requirement'. On that basis, it argued that it was unclear how the government reached the conclusion that they were 'unnecessary' relative to the benefits of protecting clients from paying ongoing fees for advice services that are underutilised or not utilised at all'.[6] It explained its concern:

> The introduction of the opt-in requirement under FOFA arose from the fact that in markets for complex financial products and services much consumer behaviour is shaped by low levels of financial literacy and related high levels of inertia. Evidence from behavioural economics clearly shows that when customers are faced with markets characterised by complexity and choice overload they are very likely to make sub-optimal decisions or make no decisions at all. In short, once they have purchased a financial product or service (which may involve paying an ongoing fee) they are unlikely to switch.[7]

7.8 In effect, the ACTU argued that abolishing the opt-in would result in more people paying for advice they do not receive.[8] COTA held a similar view that the requirement for consumers to renew their arrangement with their adviser every two years was an important consumer protection. It stated further:

> We have heard many stories of people who have no contact with their adviser but the fees keep flowing to the advisor from the product vendors.

5 Items 21 and 22.

6 *Submission 5*, p. 5.

7 *Submission 5*, p. 5.

8 *Submission 5*, p. 5.

> The business model of putting all the effort into signing people up for advice and then never reviewing or being in contact again should be a thing of the past with this particular element of the original FOFA package. Winding back this provision allows this model to flourish.[9]

7.9 According to COTA, the opt-in provision was a way of ensuring that providers 'keep in contact with consumers, have up to date contact details' and 'trigger periodic reviews'. The requirement should also encourage consumers to look at their financial goals and seek updated advice when circumstances change. Furthermore:

> It may also give them the impetus to shop around for advice and therefore promote competition and potentially reduce the cost of advice. It may also give an opportunity for people who have taken scaled advice to move to getting more holistic advice.[10]

7.10 COTA did not accept that the opt-in model was onerous on providers or that it carried high compliance costs, but rather it was 'another way of ensuring that providers are continuing to act in the best interests of their clients and optimising the advice'.[11]

7.11 The Governance Institute agreed that the opt-in provision should not be removed from the legislation.[12] It stated that this arrangement provided a strong consumer protection and promoted 'better transparency and accountability for financial advisers'.[13] While cognisant that the opt-in provision created 'an administrative burden for financial advisers', the institute opposed its removal on the basis that:

> …it places the control over the advising relationship in the hands of the financial adviser and provides no capacity for the consumer to assess if the ongoing fee arrangement remains suited to their needs.[14]

7.12 In its view, should the government decided to proceed with the removal of the opt-in requirement then 'an alternative approach should be taken to ensure that a form of consumer protection remains in place'.[15] The Governance Institute recommended that:

> …the removal of the opt-in requirement be tempered with an obligation on the financial adviser to continue to include the proposed fee arrangement in a renewal notice, as currently set out, but for the onus to revert to the client

9 *Submission 10*, p. 4.

10 *Submission 10*, p. 4.

11 *Submission 10*, p. 5.

12 *Submission 11*, p. 4.

13 *Submission 11*, p. 4.

14 *Submission 11*, p. 4.

15 *Submission 11*, p. 4.

> to terminate the relationship. That is, the renewal notice should set out the same information as is currently required, but provide that the arrangement continues unless the client explicitly elects not to renew the arrangement, and that if the client does not do anything, the arrangement will also continue. This is an opt-out requirement.[16]

7.13 CPA Australia and the Institute of Chartered Accountants Australia stated their continuing support for the mandatory two year opt-in process as an important pillar of the FOFA reforms.[17] Mr Drum argued that this mechanism ensured engagement and transparency for all ongoing advice arrangements—making sure that consumers understand what they are paying for and are comfortable doing so.[18] According to CPA Australia and the Institute of Chartered Accountants Australia:

> The opt-in requirements will assist clients who are actively involved in planning their financial future to assess whether the services they are receiving reflect value for money before they decide to renew an ongoing fee arrangement. In addition, it will encourage clients who are not actively engaged to become involved with their finances and their adviser, an important outcome given the low levels of financial literacy. It is also an opportunity for those financial advisers who do not regularly engage with their clients and seek their ongoing consent to charge advice fees to now demonstrate the real value of their advice.[19]

7.14 These two major accounting bodies also referred to the importance of transparency and integrity, which, in their view, were 'essential elements in a trusted relationship between a financial planner and a client'. They argued that these mandatory ongoing disclosure requirements would uphold the principles of transparency and integrity in all client engagements. To their mind:

> If the industry can begin to effectively communicate the benefit and value of seeking financial advice, the wider community will begin to understand these benefits and this may encourage more people to actively seek advice. This active engagement by clients will be a key element in improving trust and confidence in the industry.

7.15 But CPA Australia and the Institute of Chartered Accountants Australia, believed that the opt-in protection mechanism 'should have been afforded to both existing and new clients'. They noted, however, that a compromise of requiring the provision of an annual fee disclosure statement to all clients would 'assist in ensuring existing clients have the opportunity to make an informed decision whether they are receiving value for the ongoing fees they are being charged'.

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16 *Submission 11*, p. 4.

17 *Submission 14*, p. 4.

18 *Proof Committee Hansard*, 22 May 2014, pp 29 and 31.

19 *Submission 14*, p. 4.

7.16 Consistent with the views of the Governance Institute, they also understood that implementing new regulatory requirements comes at a cost. Nonetheless, they acknowledged that 'a balance must be struck between amending existing obligations and ensuring new rules and regulations are in the consumer's best interests and deliver positive outcomes'.[20]

7.17 Likewise, the Institute of Public Accountants recognised that some financial service providers may need to change their systems to accommodate the need for clients to 'opt-in', which would involve time and in some cases, substantial cost.[21] Even so, the IPA believed that:

> …from a client perspective, it may be preferable to have a regular reminder about the services being provided and to be afforded the opportunity to become involved, even if to just actively 'opt-out'. While for some clients this may be a nuisance; for others it may be an opportunity to improve their financial literacy and become more involved in shaping their financial future.
>
> …
>
> The information being provided to clients should include what fees they are paying, have paid and for what services. The IPA believes this is an essential part of fulfilling the FoFA objectives of providing accessible and affordable financial advice to consumers.[22]

7.18 AIST objected to the removal of the opt-in requirement, which in its view 'ensured that asset-based ongoing fees could only continue to be charged with clients' express consent'. It acknowledged that at the time the measure was introduced, it formed part of a package designed to ensure that 'money didn't continue to be bled from member accounts unnecessarily'.[23] It explained further:

> 'Trail' commissions paid to advisers or their dealer groups were in the process of being grandfathered, however there was no prohibition on asset-based ongoing fees, such as adviser service fees. We noted at the time this measure was enacted that asset-based ongoing fees could easily continue the role that trail commissions had filled and recommended that these payments stop completely.
>
> Without the opt-in requirements, these fees can continue to be charged to clients' accounts indefinitely. [24]
>
> The requirement that [advisors] get express consent from clients to opt-in every two years was, effectively, a compromise. We note that industry opposition to this measure had largely proposed maintaining the status quo,

20 *Submission 14*, p. 4.

21 *Submission 16*, p. 3.

22 *Submission 16*, p. 3.

23 *Submission 22*, p. 9.

24 *Submission 22*, p. 9.

> however we continued to support an environment where investors know what they are paying and what they are getting in return. Removal of the opt-out requirements conceals this vital information.[25]

7.19 It stated clearly that it could not support 'a situation where clients continue to be charged ongoing fees without evidence of any services being provided'. AIST cited similar arrangements outside of financial services, such as 'the notorious difficulty with terminating gym memberships', to support its argument that requiring members to opt-out is 'bad policy'. [26]

7.20 National Seniors argued that removing the opt-in provision was 'unacceptable and clearly inequitable'.[27] It was concerned that without this requirement the burden would fall on the less informed party in the financial advice contract—namely the consumer—and that most would remain inactive.[28] It stated:

> Removing the opt-in requirement pushes the obligation onto consumers to externally monitor the performance of their portfolio and the appropriateness of their current services and fee structure. It is clear that advisers are far better equipped than consumers are to perform this task.
>
> …
>
> It is a bizarre situation that the Government is proposing to subject the provision of financial advice to less stringent renewal notice requirements than are applied to general insurance arrangements.[29]

7.21 Furthermore, it argued that the opt-in requirement 'sends a message to financial advisers to refocus on consumer engagement'. National Seniors regarded the opt-in requirement as essential given Australian consumers' 'low level of engagement with financial matters', which can result in inadequate investment decisions. In its view, the original opt-in requirement would 'move a step closer to increasing consumer understanding and engagement within financial matters'.[30] It observed:

> Without the opt-in requirement National Seniors believes that advisers have no incentive to keep their clients informed as the fee agreement is automatically renewed with no requirement to attain the client's agreement. The arrangement will significantly compromise the ability of consumers to attain useful information required for decision making and result in major consumer detriment with consumers continuing to pay for services they do not want or need. [31]

25 *Submission 22*, p. 9.

26 *Submission 22*, p. 10.

27 *Submission 24*, p. 5.

28 *Submission 24*, p. 5.

29 *Submission 24*, p. 5.

30 *Submission 24*, p. 5.

31 *Submission 24*, p. 5.

7.22 In line with other submitters in favour of the opt-in requirement, Industry Super believed that removing the requirement would mean that 'indefinite ongoing advice fees can be charged, with no ongoing requirement to provide financial advice'. Ms Campo, Industry Super, referred to research showing that 'two-thirds of financial planning clients are passive and therefore not actively engaged with their planner'. In her view, this lack of engagement should be taken into account in support of retaining this important measure.[32]

7.23 Dr Marina Nehme supported the removal of the opt-in provision if the cost of applying it was 'too high'. She noted, however, the importance of the current 'opt-in' provision ensuring that 'a dialogue continues between the financial advisers and their clients—dialogue that would stop financial advisers from charging consumers for services they are not receiving'.[33] In this regard, the regulation impact statement recognised that the consumer benefits of the opt-in requirements could not be denied:

> The opt-in requirements were, and are, a paradigm shift in the battle to increase client engagement. By requiring advisers to seek client approval to continue arrangements, opt-in nudges clients into actively considering whether they are receiving service commensurate to the fees that they have paid and thereby raises the service levels of the industry.[34]

7.24 Even so, it went on to acknowledge that the requirement placed a disproportionately large burden on financial advisers.[35] The committee now considers this aspect of the opt-in requirement.

Support for removing opt-in requirement

7.25 Pattinson Financial Services was of the view that removing the opt-in requirements was 'an entirely sensible move'.[36] It argued that the financial planning industry would be 'the only profession in the country subject to this ludicrous concept if it were not removed'.[37] It argued:

> Clients have now and have always had the ability to Opt-Out by simply changing advisers. By changing advisers a client doesn't need to incur any additional transaction fees, they simply sign a change form provided by either an investment fund or insurer.[38]

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32 *Proof Committee Hansard*, 22 May 2014, p. 55.

33 *Submission 8*, p. 2.

34 Explanatory Memorandum, paragraph 5.97.

35 Explanatory Memorandum, paragraph 5.98.

36 *Submission 13*, p. [1].

37 *Submission 13*, p. [1].

38 *Submission 13*, p. [1].

7.26 The FPA supported the repeal of the opt-in requirement, arguing that this measure undermined the effectiveness of FOFA.[39] It believed that it detracted 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'.[40] In its view:

> 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.[41]

7.27 Likewise, Minter Ellison Lawyers was in favour of repealing the opt-in notice requirement.[42] Mr Batten told the committee that the opt-in notice requirement imposes a burden without benefit. The law firm argued:

> Clients should be able to opt out of advice fee arrangements at any time, but forcing the issue just creates the risk that clients cannot receive the advice they need when they really need it.[43]

7.28 The SMSF Professionals' Association of Australia supported the government’s amendments to remove the opt-in requirement on the basis that it would reduce compliance for financial advisers.[44] Menico Tuck Parrish Financial Services also supported the removal of this provision in the legislation. It formed the view that not only was the opt-in requirement very costly to produce and administer but was 'ultimately dangerous'. It explained:

> If a client does not acknowledge they wish to continue receiving services then they are assumed to have 'opted out' and must be removed from our care. In our experience, clients often ignore 'paperwork' (in whatever form) and it takes considerable resources to follow up.
>
> The danger is that a client may think we continue to monitor their situation whilst in fact we do not have the authority to do so. Although they may be at fault for not returning the paperwork, the result can be disastrous. This is not in the client’s best interest.

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39 *Submission 15*, p. 8.

40 *Submission 15*, p. 8.

41 *Submission 15*, p. 8.

42 *Submission 18*, p. 2.

43 *Proof Committee Hansard*, 22 May 2014, p. 37.

44 *Submission 21*, p. [1].

> Finally, there is a considerable amount of compliance required when both opening and closing files. Accidental opt out will become a costly exercise.[45]

7.29 The Explanatory Memorandum noted the high implementation and ongoing costs of the opt-in system, which, it stated, were likely 'to be passed through to the consumer'. The costs related to:

> …implementing and maintaining systems, additional staff involvement, other administrative overheads, and are closely linked to the number of customers; as such, these costs are anticipated to increase over time as client numbers increase.[46]

7.30 The AFA also suggested that the opt-in notice provided a very expensive process that would not add value. Mr Michael Nowak, AFA, noted that it was intended for new clients after 1 July 2013 who already receive annual fee disclosure statements so the opt-in notice in his view was a duplication.[47] The AFA maintained:

> An obligation of this nature is not reflected in any other industry or profession in Australia. The financial advice profession is not the only business that puts in place ongoing arrangements to receive client payments. There are many service provision businesses where clients continue to pay in the future based upon an agreement at the commencement of the arrangement. We do not believe that the cost and complexity that came with the Opt-in requirement was warranted.
>
> We remain concerned that with the limited timeframe of 30 days to obtain the clients agreement to continue an arrangement, that in many circumstances the client would unintentionally not respond in time.[48]

7.31 It noted further:

> The consequences of not responding within the 30 day deadline are significant, including the full and irreversible termination of the financial advice arrangement.[49]

7.32 The AFA noted the importance of rectifying some misunderstandings about the requirement. It wanted to make clear that the opt-in obligation applied only to new clients after 1 July 2013. Furthermore, they would continue to receive fee disclosure statements and hence be clearly advised of the fees they were paying and have the opportunity to terminate the relationship if they no longer considered it was delivering value. The AFA also noted that some observers thought that opt-in would address those clients who were paying ongoing trail commission to advisers but the client had

45 *Submission 19*, p. [1].

46 Explanatory Memorandum, paragraph 5.90.

47 *Proof Committee Hansard*, 22 May 2014, p. 10.

48 *Submission 29*, p. 3.

49 *Submission 29*, p. 3.

not seen the adviser for some time. It maintained that this understanding was incorrect as 'these clients were never going to receive an opt-in notice under the current legislation as they were existing clients before 1 July 2013'.[50]

Fee disclosure for new clients only

7.33 Currently, licensees must give *all* retail clients who have an ongoing fee arrangement a fee disclosure statement.[51] The fee disclosure statements provide customers with a single statement that shows, for the previous 12 months, the fees paid by the client, the services the client received, and the services the client was entitled to receive.[52]

Changes to fee disclosure statements

7.34 Under the new law, licensees who have an ongoing fee arrangement with a client must give retail clients who entered into the arrangement *after 1 July 2013* a fee disclosure statement as described above. This amendment is in line with the government's commitment to making annual fee disclosure statements prospective only. The Explanatory Memorandum notes the change is based on the premise that applying the annual fee disclosure statement retrospectively 'imposes large costs on industry, with minimal benefit'.[53]

Opposition to changes to fee disclosure arrangements

7.35 The submitters opposing the changes approached the amendments from the perspective of the consumer—those who entered into arrangements pre 1 July 2013. The ACTU noted that the Explanatory Memorandum offers no specific argument or evidence in support of this proposal to amend FOFA by making the requirement for advisers to provide a fee disclosure statement applicable only to clients who entered into their arrangement after 1 July 2013.[54] In its view:

> We have to assume that the government views the statements currently required by FOFA as constituting a 'burden on business'—albeit one that is unquantified and unproven. The possibility that such statements may provide a benefit to pre-1 July 2013 clients that justifies their requirement is simply ignored.
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> The current FOFA legislation requires such statements because it is clearly in the interests of all retail clients, regardless of when they entered into an advice arrangement, to be able to assess exactly how much they have paid to an advisor. It is a commonplace in all branches of economics that being

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50 *Submission 29*, p. 3.

51 Explanatory Memorandum, paragraph, 2.5.

52 Explanatory Memorandum paragraph 5.101.

53 Explanatory Memorandum, paragraph 2.6.

54 *Submission 5*, p. 6.

> able to readily access clear and comprehensive price-related information is vital to informed consumer choice and the development of efficient markets. This is particularly important in the context of financial products and services where complex pricing structures and forms of payment are commonplace.
>
> Abolishing the requirement for advisors to provide pre-1 July 2013 clients with a consolidated annual statement of fees will entrench already low levels of price-transparency and deprive many clients of information that may lead them to make better choices about who and how they pay for advice.[55]

7.36 The ACTU strongly supported the current requirement that all clients receive a consolidated annual fee disclosure statement.[56] Similarly, Dr Marina Nehme suggested that a change to the fee disclosure statement provisions was not needed. In her view, disclosure was desired as it provided the clients with extra protection. Thus, to her mind, all current retail clients of financial advisers who have an ongoing fee arrangement should receive a fee disclosure statement to promote the transparency of the system and enhance consumer confidence. Improved transparency would also limit abuses in the system. Additionally, Dr Nehme argued that it may be costly and confusing for advisers to keep two separate regimes of disclosure applicable in their organisation.[57] She posed the following questions about limiting the fee disclosure statement to certain people:

- Is the fee disclosure statement valuable and needed? Doubt about the value of the fee disclosure statement may arise in the mind of consumers if only certain investors receive it.
- Why are investors who entered into an arrangement prior to 1 July 2013 not subjected to the same protections as investors who have entered into an arrangement after 1 July 2013? A double standard should not be created and supported by the statute. All investors who have current arrangements with a financial adviser should receive the fee disclosure statement.[58]

7.37 According to Dr Nehme, 'transparency and accountability should be the centre of any reform in the area of financial services and not the interest of businesses'. She contended:

> The legislation should protect the most vulnerable members of our society especially when bad investments generated from bad advice may lead investors to lose their life savings.[59]

55 *Submission 5*, p. 6.

56 *Submission 5*, p. 6.

57 *Submission 8*, p. 3.

58 *Submission 8*, p. 3.

59 *Submission 8*, p. 3.

7.38 CPA Australia and the Institute of Chartered Accountants Australia supported the provision of fee disclosure statements to all clients. They were of the view that the mandatory disclosure obligation would ensure the principles of transparency and integrity were upheld in all client engagements, which would result in positive outcomes for not only clients but the wider industry.[60]

> It will also ensure a minimum level of engagement and communication between a financial adviser and a client, while acting as an important consumer protection mechanism for clients who are in an ongoing fee arrangement that is not subject to the mandatory biennial renewal.

7.39 In reference to the burden imposed on industry, CPA Australia and the Institute of Chartered Accountants Australia acknowledged the costs involved in meeting the disclosure obligations, which was a consideration in a commercial environment. Nonetheless, they held the view that 'the immediate benefits of engagement and transparency and the longer term benefits of building trust and confidence if these measures are retained must not be underestimated'.[61] To their minds, annual fee disclosure statements for all clients engaged in an ongoing fee arrangement must be retained.

7.40 CHOICE also opposed the measure that would limit consolidated statement of ongoing fees to new clients. It noted that the proposal to remove the obligation to provide an annual fee disclosure statement to consumers who entered into a contract before 1 July 2013 would 'formalise poor practice across the financial services industry'.[62] It argued:

> It is reasonable for a consumer to receive a summary of fees charged for an ongoing service. Failure to provide a summary of fees charged would be unacceptable for other industries that offer ongoing services such as telecommunications or electricity. Providing a summary of charges is a necessary cost of doing business rather than a burdensome compliance cost.[63]

7.41 In CHOICE's assessment, the repeal of the opt-in provision combined with the removal of the requirement for regular statements would increase 'the likelihood that existing clients would continue to pay for services they don’t use or need'.[64] CHOICE pointed out that many of these clients would likely be unaware of 'passive fees' currently being paid on investments including superannuation.

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60 *Submission 14*, p. 4.

61 *Submission 14*, p. 5.

62 *Submission 7*, p. 12.

63 *Submission 7*, p. 12.

64 *Submission 7*, p. 12.

7.42 The AIST also opposed the changes to the consolidated statement of ongoing fees to existing clients.[65] In agreement with CHOICE and Dr Nehme, AIST suggested that this measure would remove transparency for older clients of advisers entitled to such information following the introduction of the FOFA reforms. It also highlighted the fact that clients who entered into arrangements prior to 1 July 2013 would not know how much they were being charged.[66]

> Furthermore, we believe that this measure, combined with the removal of the opt-in requirements will create a perception that these charges are product related, and therefore unable to be opted-out of easily. This is untenable. [67]

7.43 The discriminatory aspect of the proposed changes also troubled a number of submitters including National Seniors. It was of the firm view that annual fee disclosure statements should be provided to all clients regardless of when they entered into their arrangements.[68] It similarly focused on consumer protection, noting that annual fee disclosure statements allow consumers to view all the fees they have paid and the services received over the past 12 months in an accessible and easy-to-understand format. This measure, according to National Seniors Australia, empowers consumers to make informed investment decisions. It explained:

> Unless annual fee disclosure statements are provided to all consumers, investors will have no way of knowing how much they've paid to product providers and advisers and if the advice received represents value for money. [69]

7.44 National Seniors believed that if the annual fee disclosure statement requirements were limited to post 1 July 2013 consumers, pre 1 July 2013 consumer disclosure would continue to be at the discretion of the financial adviser. This arrangement increased the likelihood of a reduction in the amount, quality and frequency of information, resulting in major consumer detriment.[70] It stated:

> This time-based discrimination will affect many older consumers denying them a fundamental benefit of the FOFA reforms and resulting in pre 1 July 2013 consumers receiving a significantly reduced and less useful level of disclosure. [71]

7.45 Furthermore, National Seniors formed the view that the majority of financial advisers 'already have the information required to develop an annual fee disclosure

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65 *Submission 22*, p. 10.

66 *Submission 22*, p. 10.

67 *Submission 22*, p. 10.

68 *Submission 24*, p. 3.

69 *Submission 24*, p. 6.

70 *Submission 24*, p. 6.

71 *Submission 24*, p. 6.

report'. It reasoned it would, therefore, not be difficult for the adviser to create such reports. National Seniors argued that in contrast, it was 'difficult, if not impossible, for consumers to determine this information for themselves'.[72]

Support for changes to fee disclosure arrangements

7.46 The FPA supported the removal of retrospectivity from the fee disclosure statement regime, arguing that this measure undermined the effectiveness of FOFA.[73] It believed that a mandatory fee disclosure statement for pre 2013 clients would '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'.[74] It stated:

> …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 not required to be disclosed in a FDS. [75]

7.47 The SMSF Professionals' Association supported the 'move to implement fee disclosure statements in a non-retrospective fashion'. It argued that this measure would reduce the compliance burden of the FOFA reforms'.[76] Similarly, Pattinson Financial Services suggested that making fee disclosure statements prospective was the only practical option:

> Unlike large advice businesses owned by the banks or supported by Industry Super Funds, small independently owned Financial Advice Businesses do not have the resources to interrogate and report on all legacy products our clients hold. In many cases these legacy products have excessive fees to exit. To service the clients' best interest the advice business will ask a client to retain a product but in doing so would have created an expensive administrative burden that would ultimately by passed on to the client.[77]

7.48 The Association of Independently Owned Financial Professionals was of the view that the opt-in and pre July 2013 fee disclosure created an unnecessary burden with little benefit to consumers.[78] Menico Tuck Parrish Financial Services Pty Ltd wanted the proposed legislation to go even further, arguing that the restriction to apply

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72 *Submission 24*, p. 6.

73 *Submission 15*, p. 8.

74 *Submission 15*, p. 8.

75 *Submission 15*, p. 8.

76 *Submission 21*, p. 7.

77 *Submission 13*, p. [1].

78 *Submission 26*, p. 4.

these to clients from 1st July 2013 should be removed altogether.[79] It explained further:

> We had been prepared to send out the statements as per the legislation on 1st July 2013 however ASIC granted a six month period under which the appropriate systems could be developed, delaying the implementation date to 1st January.[80]
>
> The shock came during the training period for the new software and legislative obligations. The amount of time needed to prepare such a statement is more than anyone thought—I had previously costed out the process at $110 per client per annum. Our experience to date indicates that this will be much higher as every statement has to be individually processed. Again, these costs will have to be passed onto the client. [81]

7.49 Menico Tuck Parrish Financial Services noted that the client receives disclosure of our ongoing fees in a range of documents:

- statement of advice;
- record of advice (relating to ongoing advice and service); and
- product provider statements which are sent to the client anywhere between quarterly to annually. Adviser service fees are clearly outlined in these.[82]

7.50 From a legislative and policy perspective, the IPA agreed that any legislation or regulatory requirement which imposed a burden on those affected 'should be prospective and not retrospective'. Apart from the practical difficulties which this created, the IPA believed that legislation should not be retrospective unless it benefits consumers/taxpayers. The IPA concluded that it was unaware of any sound reason to diverge from this long-standing approach.[83]

Timing of implementation

7.51 The FPA raised concerns about the wording of section 1531D, which in its view '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. It argued that:

> This 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.[84]

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79 *Submission 19*, p. [1].

80 *Submission 19*, p. [1].

81 *Submission 19*, p. [2].

82 *Submission 19*, p. [2].

83 *Submission 16*, p. 3.

84 *Submission 15*, pp 8–9.

7.52 In its view, the starting date for the FDS regime should remain as intended by the original FOFA reforms—that is 1 July 2013.[85]

7.53 The Association also expressed its concern that the generation of the FDSs could be complicated in several ways:

> Some information required by the FDS, such as advice fees, may rely on data generation from a third party, and this information sourcing process may be time consuming and prone to delay. For example, where the advice fee is related to asset pricing, data may need to be gathered from multiple third parties, with each being beyond the control of the planner and licensee. This raises the risk of non-compliance with the 30 day period for production of the FDS in subsection 962G(2).[86]

7.54 The FPA recommended:

- an amendment to section 1531D of Division 2 of the bill making the commencement date for fee disclosure statements requirement 1 July 2013, to reflect the original intent of the bill to apply to new clients from 1 July 2013; and
- the legislation be amended to provide financial planners and licensees with either greater flexibility to comply with the FDS 30 day disclosure period where the delay is due to reasons beyond their control or amend the 30-day disclosure period to 60 days.[87]

7.55 In a similar vein, Minter Ellison Lawyers submitted that the amendment to remove the requirement to provide yearly fee disclosure statements to existing clients should apply from I July 2013, the date this obligation commenced. They were concerned that if this change were not made retrospective, advisers and licensees would 'have the uncertainty of being subject to a requirement that was in force for a short period of time'.[88] They stated further:

> …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.[89]

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85 *Submission 15*, p. 9.

86 *Submission 15*, p. 9.

87 *Submission 15*, p. 9.

88 *Submission 18*, p. 6.

89 *Submission 18*, p. 6.

7.56 The FSC supported the suggestion that 'the repeal of the requirement to provide a fee disclosure statement to existing clients should take effect retrospectively to the date of the announcement (20 December 2013) or 1 July 2013'. It argued:

> Advisers and licensees should be given certainty that no penalty or liability can arise where they were not able to comply with the Fee Disclosure Statement requirements for clients who entered arrangements pre FoFA law applied – that is pre 1 July 2013, including where they have been relying on the Government's promise to remove this requirement.[90]

7.57 The committee suggests that the government take account of the reasons put forward by the FPA, Minter Ellison Lawyers and the FSC regarding the commencement date for the fee disclosure statements and the 30 day deadline to obtain a client's agreement to continue an arrangement.

Committee view

7.58 The committee supports the removal of the opt-in requirement. The committee understands that clients are able to opt out of their advice fee arrangement at any time and that they receive an annual fee disclosure statement. It also notes that under current arrangements if, for whatever reason, a client allows their ongoing fee arrangement to lapse, their investment remains in place but unmanaged—which is clearly not in the client's best interest. As the FPA noted, such a situation exposes the lapsed client to significant risk.

7.59 Also, while there is no doubt that the repeal of the opt-in requirement would remove an opportunity for client engagement, there are numerous other measures whereby advisers keep in contact with their clients—for example through annual fee disclosure statements.

7.60 Furthermore, the current opt-in arrangement imposes a compliance burden on financial service providers for little gain. Similarly, the requirement to provide a fee disclosure statement to pre 1 July 2013 clients places a significant regulatory burden on industry.

Conclusion

7.61 The dominant concern throughout this report has been to achieve a proper balance between providing adequate consumer protection and sound professional and affordable financial advice. Overall, the committee found that the proposed amendments strike that right balance—that the best interests duty remains robust and comprehensive and that clients can receive scaled advice without diminishing their consumer protections. The committee also concluded that the expanded exemptions to the conflicted remuneration redressed the problem of legislative overreach created by

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90 *Submission 27*, p. 32.

the original FOFA reforms. Furthermore, the exemptions were not intended to bring back commissions in any form. Even so, the committee accepts that much scope remains to bring greater clarity to these provisions and certainty that commissions will not be allowed.

7.62 Finally, the committee formed the view that while removing the opt-in requirement and limiting the fee disclosure statements to post July 2013 would reduce the opportunities for client engagement, other avenues remained open for advisers to keep in touch with their clients. These measures would also lower the significant compliance burden on financial service providers.

Recommendation 3

7.63 The committee recommends that after the government gives due consideration to recommendations 1–2, the bill be passed.

Senator David Bushby
Chair

Dissenting Report by Labor Senators

Introduction

1.1 The Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 moves to significantly weaken the Future of Financial Advice reforms put in place by the former government. In this dissenting report, Labor Senators examine the legislative process to-date and key features of the Government's legislation including: the best interest's duty, scaled advice, conflicted remuneration, and opt-in and disclosure requirement provisions, before considering the merits of the proposed legislation as a whole.

1.2 On Thursday 22 May 2014, the Senate Economics Legislation Committee conducted a one day hearing into the Government's legislation changes.

1.3 A number of industry and consumer stakeholder groups gave evidence before this committee, providing various levels of support and opposition to the bill.

1.4 A snapshot of evidence given during the one day hearing, not necessarily representative of every stakeholder position, follows:

Mr Mark Rantall, Chief Executive Officer, Financial Planning Association of Australia:

> the FPA strongly opposes any possible reintroduction of commissions for financial product advice on superannuation or investment products. There are several risks which are associated with commissions for general advice. Firstly, we are extremely wary of general advice business models which encourage a complementary sales model of financial product issuance and distribution. The conflicted remuneration which drives these business models poses a real risk of product misselling to retail investors and was rightly banned by the future of financial advice reforms. Secondly, commissions incentivise the provision as a general advice as a form of consumer education or a replacement for personal advice. General advice is inappropriate for that purpose as it makes it more difficult for consumers to distinguish personal financial advice from marketing material or product sales. Thirdly, commission payments have also eroded public confidence in our financial system. Australians will not have the confidence in our financial system as long as providers of products or advice are exposed to perverse incentives such as commissions. Finally, allowing superannuation investment commissions to be paid on general advice has the potential to shift licensees and representatives away from the provision of personal advice in order to earn commissions. As long as the differences between general advice and personal advice are insufficiently clear to consumers, general advice will be perceived as a less costly form of personal advice. This perception of general advice influenced by the perverse incentives

created by commissions increases the risk to consumers and being sold inappropriate high-risk tier one products.[1]

Mr Ian Kirkland, CEO, consumer group CHOICE:

we are concerned about the watering down of the best-interest obligation, the changes to rules about conflicted remuneration, the removal of the requirement that clients opt in to fees and the removal of the requirement for annual fee disclosure statements for arrangements commenced prior to 1 July 2013. We see these things as pretty basic consumer protections and, indeed, signs of basic good practice in business that any financial adviser should be happy to sign up to. We have noted the costs to industry that have been spoken about. We feel that the costs to consumers also need to be considered—and these are best demonstrated by some of the significant collapses and crises that we have seen where consumers have lost millions and millions of dollars. That is what happens when financial advice goes wrong. In short, we think FOFA was an important step forward. We would be deeply concerned about any winding back of the protections that were brought in through FOFA and we would encourage the committee to recommend that these amendments be abandoned.[2]

Mr Richard Webb, Policy and Regulatory Analyst, Australian Institute of Superannuation Trustees:

Mums and dads expect advice from advisers and they expect sales from sales people. Investors have an understanding of the difference between those two terms. We note that the Cooper review wrestled with this and concluded that:

... commissions should be banned on all insurance products in super, including group risk and personal insurance. Trustees will continue to be able to offer life, TPD and income protection insurance in MySuper and choice investment options ...

This was on top of the Ripoll report, which recommended banning commissions on financial products entirely at paragraph 6.56. If it is still the case that banks wish to provide conflicted remuneration to their sales staff, the answer is not to allow advice to be carved out.[3]

Ms Robbie Campo, Deputy Chief Executive, Industry Super Australia:

Industry Super Australia is concerned that the measures proposed in the bill being considered by this inquiry will significantly dilute key consumer protections in financial advice law and therefore increase the likelihood and impact of future financial advice scandals.

The general advice exemption, obviously, has attracted much criticism. The rhetoric offered in support of creating this exemption talks about the need

1 *Committee Hansard*, 22 May 2014, p. 19.

2 *Committee Hansard*, 22 May 2014, p. 11.

3 *Committee Hansard*, 22 May 2014, p. 47.

> to ensure that people can access assistance and advice, particularly from bank tellers. But, in our view, this is not really what this exemption is about. There is already a complete exemption for basic banking products in the FOFA legislation. Therefore, what we are talking about is allowing commissions and other forms of conflicted remuneration to be paid on complex products, including superannuation but also others like managed investment schemes and leveraged products, which have been the subject of many previous inquiries due to the consumer losses that have ensued.[4]

Ms Josephine Root, National Policy Manager, Council of the Ageing Australia:

> In our submission, we outline our concerns around the weakening of the best interest test, the removal of the requirement to have clients opt in every two years, the allowance of scaled or scoped advice and the move to allow commissions for more general advice products. No doubt there will be some questions on our views.
>
> We believe the cumulative effect of these changes is to seriously weaken the reforms, giving less consumer protections and ultimately undermining confidence in the financial advice sector. We are concerned that people will opt out of getting financial advice and, therefore, not get the maximum benefits that they could and in the long term be a cost on the taxpayer and government because they will move to not having sufficient funds in retirement.[5]

1.5 Experienced financial journalist, writer at the Business Spectator, and ABC Finance Reporter, Mr Alan Kohler, wrote an opinion piece on 26 March entitled 'Why FoFA should have been only the start of reform' where he said:

> Acting Assistant Treasurer Mathias Cormann should do much more than tweak the amendments to the Future of Financial Advice legislation after he consults "in good faith"; he needs to rethink the Government's whole approach to the subject.
>
> Under the cover of streamlining the laws and removing red tape to lower cost, the Government is proposing eight changes to the law that will allow banks to once again use licensed financial advisers to sell investment products while pretending to provide independent advice.[6]

1.6 And:

> These amendments add up to the comprehensive return of disguising sales as independent advice, which the advisers themselves have been trying to get away from.

4 *Committee Hansard*, 22 May 2014, p. 55.

5 *Committee Hansard*, 22 May 2014, p. 66.

6 www.businessspectator.com.au/article/2014/3/26/politics/dont-tweak-minister-rethink

> Not only does it make them feel grubby and deceptive to pretend to be advising when they are actually selling stuff on commission, they know that fewer and fewer people will get advice if they can't trust it.[7]

1.7 In February 2009, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) resolved to inquire into issues associated with the provision of financial products and services in Australia. The inquiry was initiated in response to a string of high profile collapses of financial product and service providers, such as Storm Financial and Opes Prime.[8]

1.8 The committee's final report in November 2009 (the PJC report) found that significant changes to the regulatory regime for the financial advice industry were warranted. It made a series of recommendations designed to 'enhance professionalism within the financial advice sector and enhance consumer confidence and protection'.[9]

1.9 In response to the PJC report and a comprehensive consultation process the former Labor government introduced the Corporations Amendment (Future of Financial Advice) Bill and the Corporations Amendment (Further Future of Financial Advice Measures) Bill. These bills were subject to a further inquiry by the PJC and received Royal Assent on 26 June 2012.

The process

1.10 The Government has simply not made the case for changing the Future of Financial Advice (FOFA) reforms and that is borne out through the evidence before this committee inquiry.

1.11 The process that culminated in the introduction of the legislation under review began with the former Assistant Treasurer releasing details for public consultation days before Christmas. The shambolic and chaotic 'two track' process, of pursuing regulation mirrored by legislation, has caused considerable uncertainty for businesses and widespread concern for Australian investors.

1.12 The methodology and lack of process adopted by the Government to dismantle the FOFA reforms has created uncertainty and concern resulting in a broad-based community coalition against any government changes to these reforms.

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7 www.businessspectator.com.au/article/2014/3/26/politics/dont-tweak-minister-rethink

8 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 4.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*, February 2012, p. 4.

1.13 The proposed Government changes are not minor or technical in nature but rather a complete undermining of the core principles of best interests duty, consumer protection and lifting the standards to a professional level.

1.14 In summary, the Government's bungling of the process to put in place regulations and legislation is such that even moves to make sensible technical or grandfathering changes are likely to face significant community-led resistance.

1.15 Labor Senators note the announcement by the acting Assistant Treasurer of 24 March that the Government has 'paused' the implementation of planned Regulations, and in the intervening period, there have been discussions with industry stakeholders on new legislative and regulation changes to the FOFA laws, independent of this Senate inquiry process.

1.16 The acting Assistant Treasurer committed to 'consult in good faith with all relevant stakeholders on the Future of Financial Advice Regulations'. But it is clear to Labor Senators that this engagement has been limited and not dealt with the substantive concerns of many parts of the financial services sector.

Best Interests Duty

1.17 The Best Interests Duty is a key element of the original FOFA reforms aimed at improving the quality of financial advice, this duty provided that advisers must act in the best interests of the client.

1.18 Labor Senators note the evidence of Mr Paul Drum, CPA Australia, the best interests duty is the 'cornerstone of the FOFA reforms', with 'the ability to drive a cultural change within the financial services industry'.[10]

1.19 The bill seeks to remove paragraph (g) in Section 961B(2) of the 'safe harbour' provisions, known as the 'catch-all' of the Best Interests Duty as well as section 961E.

1.20 Labor Senators also note that the Safe Harbour provisions through section 961B are designed to provide security and protection for advisors by ensuring a proper process including part (g), which is further explained in the regulations to provide clarity.

1.21 Labor Senators note the concerns of some in regards to 961B(g) however agree with Professor Paul Latimer that the open-ended nature of 961B(g) ‘removes a static and inflexible advice model (box ticking) that may fail to take full account of all the client's relevant circumstances'.[11]

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10 *Committee Hansard*, 22 May 2014, p. 29.

11 *Submission 2*, p. 13.

1.22 Labor Senators note that concerns raised by the Council Of The Ageing (COTA) around the removal of 961B(g) that:

> If this last step were to be removed the other six steps become a 'tick a box' checklist and weaken the requirement for advisors to reflect in an overall sense on the advice they are giving and whether it would as a whole be considered in the client's best interest. The inclusion of paragraph (g) provides an extra degree of security for consumers that the advisor is acting for them.[12]

1.23 It is also clear that no evidence or cases of failure have been found or presented to this Inquiry in relation to part (g), which has been in operation since 1 July 2012.

1.24 Labor Senators believe that the best interest duty is driving cultural change in the industry and that removal of 961B(g) and 961E will reduce compliance with the best interest duty to little more than 'tick-a-box' approach and has the potential to result in the provision of poor advice not in the client's best interests.

Scaled Advice

1.25 A key objective of the FOFA reforms was to facilitate access for retail clients to financial product advice, including 'scaled' advice, that is, personal advice that is limited in scope.[13]

1.26 The bill seeks to aid in the provision of 'scaled' advice by the addition of subsection 961B(4A) and new paragraph 961B(2)(ba).

1.27 Labor Senators agree with the potential of 'scaled' advice to increase the quantity and reduce the cost of financial advice sought by Australians.

1.28 However Labor Senators are particularly concerned that the proposed changes in the bill will lead to advice that does not fully take into account the relevant circumstances of the client and is not in the client's best interests.

1.29 Particularly, Labor Senators note an ASIC shadow shopping survey that, ASIC, when reviewing the results, saw some evidence that the scope of advice was inappropriate. It noted that in several instances, 'particular topics were excluded from the scope of the advice, to the potential benefit or convenience of the adviser, and to the significant detriment of the client'.[14]

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12 *Submission 10*, p. 4.

13 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, p. 7.

14 ASIC, Consultation Paper 183, *Giving information, general advice and scaled advice*, August 2012, p. 8.

1.30 Labor Senators also particularly note the concerns of Ms Robbie Campo of Industry Super Australia (ISA) who cited the Explanatory Memorandum that 'this mechanism would be able to be used by a client and adviser to agree that only the products of a particular provider would be considered in the advice'.[15]

1.31 Labor Senators note that changes that would allow an adviser to benefit from excluding topics from advice, as well as changes that allow that only products from a particular provider be considered cannot possibly be regarded as meeting the intention of the best interests duty.

Conflicted Remuneration

1.32 The banning of conflicted remuneration, with some minor exemptions, from general advice and personal advice was a significant factor in reforming the culture and public perception of financial advice.

1.33 The bill seeks to lift the ban on conflicted remuneration in prescribed circumstances for general advice and redefines what is to be considered conflicted remuneration for personal advice.

1.34 Labor Senators note that concerns raised by stakeholder groups, including financial planning industry associations, around the reintroduction of conflicted remuneration structures and the potential for this to lead to unethical practices.

1.35 Labor Senators also note the evidence of Mr Matthew Linden from Industry Super Australia who quoted research from Rice Warner on the direct cost to consumers of the changes, including the return of conflicted remuneration, in the bill:

> On an annual basis, they estimate the costs are more than half a billion dollars – almost three times the estimated business savings.[16]

1.36 Labor Senators believe it is irresponsible for any government to make changes that have the potential to cost consumers up to half a billion dollars annually.

1.37 Labor Senators note the concerns raised about the use of the term 'general advice', particularly the potential for confusion among investors on the nature of the advice received and recommend that the Government legislate to change this term to 'general information'.

1.38 Labor Senators agree that consumers may be confused by the persons who offer financial product information/factual information representing themselves as financial planners or financial advisers.

1.39 Labor Senators note suggestion of the Financial Planning Association (FPA) that the term financial planner/adviser should be defined by legislation.

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15 *Committee Hansard*, 22 May 2014, p. 55.

16 *Committee Hansard*, 22 May 2014, p. 56.

1.40 Labor Senators note that the former Labor government had introduced the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013 Schedule 2 of which sought to restrict the use of the term 'financial planner' and 'financial adviser'. This bill lapsed when the parliament was prorogued.

1.41 Labor Senators recommend the Government reintroduce the measures in Schedule 2 that will restrict the use of the terms 'financial planner' and 'financial adviser'.

Opt-in and annual disclosure requirements

1.42 A key feature of FOFA was the requirement for industry participants to seek their clients confirmation to pay for on-going financial advice every two years also known as opt-in, (or as a substitute to this be required to join an industry body with an ASIC approved code of conduct), as well as the introduction of a prospective annual fee disclosure statement for all clients from the commencement of the Legislation. These features were about promoting a transparent financial planner-client relationship where the client has a solid basis for confidence in the quality of advice being provided.

1.43 The bill seeks to remove the opt-in provisions entirely and to restrict the provision of annual fee disclosure statements only to retail clients who entered into the arrangement after July 1 2013.

1.44 While noting the concerns of industry about the administrative cost of opt-in and fee disclosure Labor Senators agree with the belief of Industry Super Australia that removal of opt-in will mean 'indefinite ongoing advice fees can be charged, with no ongoing requirement to provide financial advice'.[17]

1.45 Labor Senators agree with National Seniors that opt-in 'sends a message to financial advisers to refocus on consumer engagement'. National Seniors regarded the opt-in requirement as essential given Australian consumers' 'low level of engagement with financial matters', which can result in inadequate investment decisions. In its view, the original opt-in requirement would 'move a step closer to increasing consumer understanding and engagement within financial matters'.[18]

1.46 Further, Labor Senators agree with National Seniors that removing the opt-in provision was 'unacceptable and clearly inequitable'.[19] It was concerned that without this requirement the burden would fall on the less informed party in the financial advice contract—namely the consumer—and that most would remain inactive.[20] It stated:

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17 *Committee Hansard*, 22 May 2014, p. 55.

18 *Submission 24*, p. 5.

19 *Submission 24*, p. 5.

20 *Submission 24*, p. 5.

> Removing the opt-in requirement pushes the obligation onto consumers to externally monitor the performance of their portfolio and the appropriateness of their current services and fee structure. It is clear that advisers are far better equipped than consumers are to perform this task …
>
> It is a bizarre situation that the Government is proposing to subject the provision of financial advice to less stringent renewal notice requirements than are applied to general insurance arrangements.[21]

1.47 Labor Senators are also concerned about the proposed change to fee disclosure statements that would apply for new clients only. The current legislation is for disclosure to apply in relation to all clients and to diminish this to only new clients from 1 July 2013 is a retrograde change.

1.48 Labor Senators agree with the statement of the Australian Council of Trade Unions (ACTU) that 'abolishing the requirement for advisors to provide pre-1 July 2013 clients with a consolidated annual statement of fees will entrench already low levels of price-transparency and deprive many clients of information that may lead them to make better choices about who and how they pay for advice'.[22]

1.49 Labor Senators also note the extensive removal of disclosure through paragraph 2.27 of the Explanatory Memorandum that explicitly allows for fees to be altered without consent:

> Generally speaking, alterations in the terms such as a simple alteration of an existing fee, an alteration in the duration of the arrangement, or where the fee recipient merged or was taken over by another company, but the existing arrangement did not otherwise change, would not constitute a new ongoing fee arrangement.[23]

1.50 Labor Senators believe that the requirement to provide an annual fee disclosure statement should be maintained for all clients from 1 July 2013 regardless of when their arrangement was entered into as this maintains the principle of fee disclosure equally and in a fair manner.

Conclusion

1.51 Labor members of the committee note the majority report's recommendations 1 and 2 are little more than a piecemeal attempt to fix structural legislative gaps and failures using the explanatory memorandum.

1.52 Labor members of the committee believe that the bill in its current form is beyond repair and should be opposed. Furthermore, the Government should abandon

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21 *Submission 24*, p. 5.

22 *Submission 5*, p. 6.

23 Explanatory Memorandum, Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, p. 21.

any attempts to rush in, again, a new set of regulations that in effect gut the FOFA reforms ahead of introducing new legislative charges. The lesson for the Government over the last 6 months has been that this flawed approach will only be met by hostility in the parliament and in the community.

1.53 If the Government wishes to proceed with minor and/or technical changes that facilitate industry compliance with the original FOFA reforms, then it should enter into good faith discussions with all stakeholders, including those who represent investor and consumer interests, and all parliamentary political parties.

Recommendation 1

1.54 Labor members of the committee recommend that the bill not proceed.

Recommendation 2

1.55 Labor members of the committee recommend the Government legislate to change the term 'general advice' to 'general information'.

Recommendation 3

1.56 Labor Senators recommend the Government reintroduce the measures in Schedule 2 of the Corporations Amendment (Simple Corporate Bonds and Other Measures) Bill 2013, to restrict the use of the terms 'financial planner' and 'financial adviser'.

Senator Mark Bishop
Deputy Chair

Senator Louise Pratt
Senator for Western Australia

Dissenting Report by Australian Greens

1.1 The Australian Greens do not support the recommendations of the majority report to the inquiry into the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014.

1.2 As canvassed by the report, the debate and consultation around FOFA has been ongoing since 2010. The FOFA reforms passed both houses with amendments and received royal assent on 27 June 2012.

1.3 The aim of the FOFA measures were to:

> Improve the quality of financial advice while bundling trust and confidence in the financial advice industry through enhanced standards which align the interest of the advisor with the client and reduced conflicts of interest.[1]

1.4 The Coalition Government has introduced amendments to this legislation arguing that compliance costs and unnecessary red tape are driving costs of financial advice too high.

1.5 Based on submissions and evidence in the public hearing, the Australian Greens believe that this push is being primarily driven by large financial services companies, banks and their lobby groups such as the Australian Bankers' Association and the Financial Services Council.

1.6 Evidence from Ms Tate representing the Australian Bankers' Association at the hearing indicated that they thought their lobbying had been successful:

> Senator WHISH-WILSON: One thing I know corporations are really good at doing is managing risk. They are always forward-looking and they are always incorporating these things into their decision making. You have not changed your compliance, from what I am understanding now, because you obviously have an expectation that these laws are going to be changed for you.
>
> Ms Tate: We do have an expectation, because we had bipartisan support prior to the last election that these things would happen. If they do not happen, it just means that expedited and fast changes need to be made.
>
> Senator WHISH-WILSON: In what sense was it bipartisan? Well, tri-partisan would be a better word to use. Was that formal? Do you have records of these conversations?
>
> Ms Tate: With the former government, we had been talking with Treasury about having changes made via the regulations to sort this out. The current

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1 See Replacement Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, General Outline, p. 3.

> government is on record publicly as saying that they were sorting these things out.[2]

1.7 Through their submissions and the evidence given at the hearing, some of the financial services industry indicated that they believed there were high costs to themselves and consumers from the existing FOFA reforms. Other groups such as CHOICE and National Seniors emphasised the importance of balancing any costs with the importance of protecting consumers.

1.8 In relation to conflicted remuneration on general advice, the Australian Greens support the view of the Financial Planning Association of Australia who stated at the public hearing that:

> We are extremely wary of general advice business models which encourage a complementary sales model of financial product issuance and distribution. The conflicted remuneration which drives these business models poses a real risk of product mis-selling to retail investors and was rightly banned by the future of financial advice reforms.[3]

1.9 This is the view we support because of the necessary cultural changes that are underway in the financial services industry. The committee inquiry heard a number of witnesses outline the toxic culture that existed in some areas of the industry. Recent media stories and other Senate inquiries have also heard evidence of a culture that does not respect clients and their goals.

1.10 The Australian Greens believe incentives that lead to conflicted remuneration (including commissions and other elements of a bonus culture) should remain banned as an incentive which in some cases has driven illegal behaviour and unethical culture within some financial services organisations (notably larger financial organisations).

1.11 In relation to the other proposed amendments, the Greens spoke to a number of smaller financial planners prior to the inquiry and acknowledge that feedback on the suite of amendments was mixed. We acknowledge concerns by some smaller financial planners around 'potential' uncertainty from the "catch all provision" and higher compliance costs from various other FOFA reforms (such as opt-in clauses) but we feel that these need to be carefully weighted against expected benefits to both consumers of financial services and the financial services industry.

1.12 The Australian Greens believe it is difficult to gauge the accuracy of the projected costs put forward by the industry because the current legislation has not been in place for very long. Following a defined amount of time, an independent review of all potential costs (including compliance, lost business, opportunity costs, costs of advice, access to affordable advice) and potential benefits (increased trust in

2 *Committee Hansard*, 22 May 2014, p. 80.

3 Mr Rantall, Chief Executive Officer, Financial Planning Association of Australia, *Committee Hansard*, 22 May 2014, p. 19.

financial industry, increase in Australians accessing advice, increased provision of fee for service advice versus general advice and stability of the financial sector) should be conducted.

1.13 The view of some stakeholders was that not enough time had elapsed to make a judgement on the previous government's reforms at this stage.

1.14 The Committee should take the opportunity to make recommendations to the Government about the benchmarks and parameters for this review.

1.15 It was disappointing that during the conduct of the hearing the Government's line of questioning particularly targeted the conduct of Industry Super Funds, something that was outside the inquiry’s scope.

1.16 The Greens feel that it is too early to consider such amendments that seem designed to protect the profits of larger financial services companies, given obvious dangers to consumers (reflected in very recent scandals) and the need to transition the financial services industry towards increased consumer confidence and improved uptake of financial services and towards the provision of personal advice over general advice.

Recommendation 1

1.17 The Senate should not pass the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014.

Recommendation 2

1.18 An independent review of the effectiveness of the legislation should be established after 5 years.

Senator Peter Whish-Wilson
Senator for Tasmania

APPENDIX 1
Submissions received

Submission Number	Submitter
1	Financial Industry Network Australia
2	Associate Professor Paul Latimer, Department of Business Law and Taxation, Monash University
3	National Insurance Brokers Association of Australia
4	Stockbrokers Association of Australia
5	Australian Council of Trade Unions
6	Boutique Financial Planners
7	CHOICE
8	Dr Marina Nehme, Faculty of Law, University of New South Wales
9	Insurance Council of Australia
10	COTA Australia
11	Governance Institute of Australia Ltd
12	Customer Owned Banking Association
13	Pattinson Financial Services Pty Ltd
14	CPA Australia and the Institute of Chartered Accountants Australia
15	Financial Planning Association of Australia
16	Institute of Public Accountants
17	Corporate Super Specialist Alliance
18	Minter Ellison Lawyers
19	Menico Tuck Parrish Financial Services Pty Ltd
20	Bank of Queensland
21	SMSF Professionals' Association of Australia Limited
22	Australian Institute of Superannuation Trustees
23	Platinum Asset Management

24	National Seniors Australia
25	Australian Bankers' Association
	• supplementary submission
26	Association of Independently Owned Financial Professionals
27	Financial Services Council
	• supplementary submission
28	Save our FoFA
29	Association of Financial Advisers Ltd
30	Westpac Group
31	Industry Super Australia
	• 2 supplementary submissions
32	Commonwealth Bank
33	The Treasury
34	Confidential
35	Confidential
36	Confidential

APPENDIX 2

Additional information received

- Opening statement tabled by the Financial Services Council at a public hearing held in Canberra on 22 May 2014;
- Additional information received from the Financial Planning Association of Australia on 22 May 2014: 'FPA's 10 Point Plan to raising standards in the financial planning profession', relating to the public hearing held in Canberra on 22 May 2014;
- Additional information received from the Financial Planning Association of Australia on 22 May 2014: White Paper 'The Future Profession'; relating to the public hearing held in Canberra on 22 May 2014;
- Additional information received from the Financial Planning Association of Australia on 22 May 2014: FPA Professional Framework; relating to the public hearing held in Canberra on 22 May 2014;
- Additional information received from National Seniors Australia on 20 May 2014: A legal analysis by Dr Paul O'Shea; relating to the public hearing held in Canberra on 22 May 2014;
- Additional information received from National Seniors Australia on 23 May 2014: The Role of Financial Literacy and Financial Adviser Anxiety in Older Australians' Advice Seeking; relating to the public hearing held in Canberra on 22 May 2014;
- Additional information received from the Association of Superannuation Funds of Australia on 13 June 2014, relating to the public hearing held in Canberra on 22 May 2014;
- Answer to a question on notice from a public hearing held in Canberra on 22 May 2014, received from CHOICE on 2 June 2014; and
- Answer to a question on notice from a public hearing held in Canberra on 22 May 2014, received from the Treasury on 3 June 2014.

APPENDIX 3

Public hearing and witnesses

CANBERRA, 23 FEBRUARY 2012

BATTEN, Mr Richard, Partner, Minter Ellison Lawyers

BRAGG, Mr Andrew, Director, Policy and Global Markets, Financial Services Council

BROWN, Mr Christopher, Partner, Minter Ellison Lawyers

CAMPO, Ms Robbie, Deputy Chief Executive, Industry Super Australia

DE GORI, Mr Dante, General Manager Policy and Conduct,
Financial Planning Association of Australia

DRUM, Mr Paul, Head of Policy, CPA Australia

ELVY, Mr Hugh, Head of Financial Advisory Services,
Institute of Chartered Accountants Australia

FOX, Mr Brad, Chief Executive Officer, Association of Financial Advisers

FRASER, Mr Bede, Manager, Financial Services Unit,
Financial System and Services Division, Markets Group, the Treasury

KIRKLAND, Mr Alan, Chief Executive Officer, CHOICE

LINDEN, Mr Matthew, Director of Public Affairs, Industry Super Australia

MACAULAY, Ms Louise, Senior Executive Leader, Financial Advisers,
Australian Securities and Investments Commission

NOWAK, Mr Michael, National President, Association of Financial Advisers

O'NEILL, Mr Michael, Chief Executive, National Seniors Australia

O'SHEA, Dr Paul, Consultant, National Seniors Australia

QUINN, Ms Meghan, General Manager, Financial System and Services Division,
Markets Group, the Treasury

RANTALL, Mr Mark, Chief Executive Officer,
Financial Planning Association of Australia

ROOT, Ms Josephine, National Policy Manager, COTA Australia

ROWE, Mr Matthew, Chair, Financial Planning Association of Australia

STORNIOLO, Ms Cecilia, Senior Policy Manager, Financial Services Council

TATE, Ms Diane, Executive Director, Retail Policy, Australian Bankers' Association

TEE, Mr Kevin, Analyst, Financial Services Unit,
Financial System and Services Division, Markets Group, the Treasury

TURNER, Ms Erin, Policy and Campaigns Advisor, CHOICE

WEBB, Mr Richard, Policy and Regulatory Analyst,
Australian Institute of Superannuation Trustees

YATES, Mr Ian AM, Chief Executive, COTA Australia