

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

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26 February 2014

Question: AET 1596-1609

**Topic: Enforcement of Future of Financial Advice Reforms
& Response to Government changes**

Written: 6/03/2014

Senator Wong asked:

1596. Have ASIC sought legal advice on whether the ASIC statement on non-enforcement regarding FOFA reforms under consideration of the Government provides protection to any financial planner that breaches the current FOFA law?

1597. Has ASIC undertaken any assessment of whether that Statement will increase the changes of a breach of the law?

1598. Can ASIC please provide the committee with copies of any advice or memos [prepared for internal purposes only, not advice to Government] regarding the Government's proposed regulatory and legislative amendments to the FOFA laws.

1599. In relation to the Government's announced changes:

a. What kind of activity would typically be provided as general advice?

b. What kind of activity is typically provided as personal advice?

c. Is it easy to always draw the line between general and personal advice?

d. Can you engage in selling a product through general advice?

e. How many people are able to provide personal advice in Australia?

f. How many people provide general advice?

g. If commissions were payable on general advice, how would you police it to ensure that there is not mis-selling through general advice? Would you have the resources currently to be able to effectively resource the enforcement of general advice if problems were to emerge?

h. From your enforcement work, before FoFA, was it typical for general advice providers to be paid commissions or other conflicted remuneration? That is, were bank tellers paid commissions or incentives to sell product through general advice? What about financial planners? Call centre operators involved in direct sales? Providers of seminar services? Online providers?

i. If general advice is exempted, is it your understanding that this would allow commissions to be paid on complex products? Has there been any problems in the past with complex products being sold through direct/general advice channels?

j. What are the protections for consumers when general advice is provided – are they told if a commission is being paid in relation to the product they are being encouraged to buy?

Conflicted remuneration

1600. In your experience in regulating the financial planning industry, how significant a factor is conflicted remuneration in poor quality advice?

a. What other factors cause poor advice?

Best Interests Duty

1601. In your experiences of regulating the industry, what is your understanding of the delivery of scaled forms of advice? is there evidence of increased provision of limited forms of advice in recent years?

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1602. Is lack of trust and confidence in financial advisers a contributing factor in the 4 out of 5 Australians who don't seek advice?

1603. So the issue of ensuring that consumers can trust that advice is impartial and in their best interests is a critical factor in increasing Australians preparedness to utilise advisers?

1604. Is it possible under the current BID (pre-Government changes) to provide a limited piece of advice? Does the adviser have to do a full fact find? How do they limit the advice and act in the client's best interests?

1605. What do you think the current (g) limb of the BID duty requires an adviser to do?

Regulatory Impact Statement/Advice to Government

1606. Was your advice sought on the consumer impact of the FoFA Streamlining changes?

Best Interests Duty Changes

1607. It has been reported that the legislative changes were overstated because financial advisers are already subject to a 'fiduciary duty' at common law.

1608. In your regulatory activity, do you think that financial planning practice adheres to a fiduciary duty? Do compliance processes assume the need to adhere to a common law fiduciary duty?

1609. Is there a risk that if there is a legislative duty which sets a planner's responsibility at a lower level than a fiduciary or best interests obligation, this could create a tension in the law? Could this open up the risk of legal uncertainty?

Answer:

1596. ASIC has not sought legal advice. It is clear that ASIC's statement falls under ASIC's Regulatory Guide 108 *No-action letters*. It is a statement of ASIC's regulatory intent at the time that it is made. It has no impact on actions taken by third parties against a financial planner (paragraph RG 108.2).

1567. ASIC analysed the impact of its statement and concluded that, given its existing facilitative approach, it was unlikely to increase the chances of breaches of the law, nor limit ASIC's ability to take appropriate action against breaches of the law.

1568. Official witnesses are not meant to be asked to give opinions on matters of Government policy. The requested advice or memos substantially consist of such opinions. Accordingly it would not be appropriate to provide them to the Committee.

1569.

a. General advice is defined as financial product advice that is not personal advice (section 766B(4) of *the Corporations Act 2001* (the Act)).

Personal advice is financial product advice that is given or directed to a person in circumstances where:

the provider of the advice has considered one or more of the person's objectives, financial situation and needs; or

a reasonable person might expect the provider to have considered one or more of those matters.

There are many forms of general advice, for example:

reports or statements of opinion: *eg stock reports sent to clients or presentations given in investment seminars;*

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statements of opinion and recommendations in client newsletters;
recommendations by front line staff in banks, building societies and credit unions;
advice by in-house advisers working for industry and retail superannuation funds;
recommendations made by front line or call centre staff: *eg insurance call centre staff offering information about third party cover vs comprehensive cover in response to a request for a quote on the best value comprehensive car insurance.*

b. There are many forms of personal advice, for example:

financial planners giving a client traditional 'holistic' advice;

stockbrokers giving advice to clients regarding shares; and

superannuation funds giving advice to members regarding superannuation.

c. In some circumstances it can be difficult to draw the line between general and personal advice. In administering the law, ASIC will take into account all the circumstances when considering whether advice is personal or general. For example:

Did the person giving the advice offer to provide personal advice?

Did the person giving the advice clearly explain whether they were providing personal advice or general advice to the client?

Did the client request personal advice?

Did the person giving the advice request information about the client's relevant circumstances?

For a more detailed explanation, please refer to paragraphs RG 175.43-RG 175.54 in Regulatory Guide 175 *Licensing: Financial product advisers – Conduct and disclosure.*

d. Yes. This is particularly common in some sectors of the industry; for example, banks, building societies, credit unions, general insurers, industry and retail superannuation funds and advisers employed by issuers of more complex products eg contracts for difference (CFDs) and issuers of foreign exchange (FX) products.

e. There are 39,953 authorised representatives authorised to provide personal advice. This includes individuals and corporate authorised representatives. We estimate that there are 13,983 employee representatives who give personal advice. Therefore we estimate that there are 54,000 individual advisers giving personal advice.

However, this estimate needs to be treated with some caution for two reasons. First, ASIC's systems do not capture adviser numbers. There is no register of individual employee representatives or any other practical means by which ASIC could obtain this information

Secondly, the regulatory structure of authorised representatives and corporate authorised representatives mean that there is a certain level of double counting.

f. There are 53,370 authorised representatives authorised to provide general advice. This includes individuals and corporate authorised representatives. We do not have information on which we could estimate the number of employee representatives authorised to give general advice.

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These figures are subject to the same qualifications as outlined above.

g. ASIC uses a variety of methods to identify and gather evidence of misconduct in the financial advice industry, including: proactive random or targeted surveillances; reactive surveillances in response to, for example, reports of misconduct from whistleblowers or members of the public; shadow shopping; and, liaising with industry.

We would use all these methods, as appropriate and within our resources, to determine if there is mis-selling through general advice.

The lack of documents, for example, written Statements of Advice, in the general advice context create evidential challenges for us that are not encountered when surveillances are undertaken in relation to personal advice.

ASIC will adopt a risk-based approach to ensure that we use our available resources most efficiently.

h. Prior to the Future of Financial Advice reforms (FOFA) many providers of general advice were paid commission or other conflicted remuneration. The law did not prohibit commissions being paid to, for example, bank tellers, financial planners, call centre operators or seminar operators selling products through general advice.

ASIC does not have detailed data on the extent of this practice, but in our experience it is widespread.

i. In Australia complex products, like any financial product, can be sold with personal advice, general advice or no advice.

If commissions are allowed for general advice some issuers of complex products may reintroduce commissions for those who sell their products using a general advice model.

We have had problems in the past with complex products being sold through a general advice model. For example, in 2010 ASIC published Report 205 *Contracts for difference and retail investors* which looked at the sale of Contracts for Difference (CFDs) with general advice, for example in seminars, and identified a number of concerns with this practice.

j. Generally, an adviser who provides general advice must give a client a general warning that states:

the advice has been prepared without taking into account their objectives, financial situation or needs;

the client should, therefore, consider the appropriateness of the advice, in light of their own objectives, financial situation or needs, before acting on the advice; and

if the advice relates to the acquisition, or possible acquisition, of a particular financial product, the client should obtain a Product disclosure Statement (PDS) (if required) relating to the product and consider the PDS before making any decision about whether to acquire the product: s 949A(2) of the Act.

Briefly, a PDS includes information such as:

fees payable in respect of a financial product;

risks of a financial product;

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benefits of a financial product; and
significant characteristics of a financial product.

If the relevant financial product will or may generate a return to the holder of the product, the PDS must have information about any commission, or other similar payment, that will or may impact on the amount of such a return. However, this is high level information rather than specific information about what commissions an adviser is paid for a specific piece of advice to a particular client. ASIC's experience is that many retail clients do not read PDSs. This is particularly true for advised clients.

Generally, an AFS licensee or an AR must give a retail client a Financial Services Guide (FSG) if they provide a financial service (such as general advice) to retail clients. Amongst other matters the FSG must have information about the means by which the service provider is remunerated for the services being offered to the retail client including details of commissions.

Also relevant are the general obligations in s912A of the Act that apply to all AFS licensees. For example, the obligation to:

have in place adequate arrangements for the management of conflicts of interests that may arise. Again, such arrangements are likely to include only this is high level information about commissions.

have a compliant internal and external dispute resolution procedure.

Please note that there are exemptions (in the Act, Corporations Regulations 2001 and ASIC class orders) that modify these obligations in specific circumstances.

Conflicted remuneration

1600. Conflicted remuneration is a very significant factor in poor quality advice as it creates a conflict of interest. ASIC's experience regarding this issue is discussed in detail in the submission to the *PJC Inquiry into Financial Products and Services in Australia*.

- a. Other factors that cause poor advice include
 - other conflicts of interest (eg ownership conflicts of interest);
 - low levels of adviser training, competence and qualifications,
 - poor compliance systems and supervisory arrangements.

Best Interests Duty

1601. ASIC has in the past encountered some problems with inappropriately scaled advice. For example:

ASIC Report 279 *Shadow shopping study of retirement advice* found most advice was scaled to some extent. We also noted issues with advisers scoping out relevant and important issues from the scope of their retirement advice. We noted concern that such scoping was inappropriate as the excluded items should have been considered as part of retirement planning advice.

In ASIC's recent work on structured products we saw cases where the scope of the advice was limited to the single specific structured product, which was recommended to the client.

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In response to a survey ASIC conducted of 60 AFS licensees who provided personal advice to retail clients in late 2013/early 2014 regarding the recent rollout of FOFA, we found that 14% of respondents stated they were providing more scaled advice as a result of FOFA, while one responder said it was providing less scaled advice as a result of FOFA. (Please note, a report detailing our findings in this survey has not yet been released publically.) We are not able to provide other data on increases in the provision of scaled advice in recent years

1602. In ASIC Report 224 *Access to financial advice in Australia* consumer mistrust is one of the 6 identified issues that adversely impact access to advice. Specifically, that report states that: "*Lack of trust in financial planners to provide unbiased, professional advice limits the number of consumers who seek advice and the value they place on financial advice.*"

The other factors are:

Cost of advice: the gap between what consumers are prepared to pay and how much financial advice costs.

Scale of advice provided: many consumers prefer piece-by piece advice over the holistic advice many advisers offer as default.

Consumer perceptions that advice is out of their reach: consumers who do not seek advice because they feel their financial circumstances do not warrant it.

Access to general advice and information: the provision of general advice or factual information is less extensive than it could be. For many consumers, general advice and factual information is sufficient to deal with their advice needs at a particular point in time..

Financial literacy: poor financial literacy can disengage some consumers.

1603. Consumer trust and confidence in advisers is one of the factors that affects demand for advice.

1604. ASIC considers it is possible to provide limited or scaled advice under the existing best interests duty in s961G and has provided guidance to this effect in ASIC Regulatory Guide 244 *Giving information, general advice and scaled advice* (RG 244).

In regards to a full fact find, RG 244 advises that the level of enquiries should be adjusted to reflect the nature of the advice being provided. For example, when a client's relevant circumstances are straightforward, the scale of the inquiries may be quite limited.

Advice can be limited but still adhere to the best interest duty if the type of advice service offered is clearly communicated, for example, explaining the scope of advice to client and that no other issues will be considered.

1605. ASIC Regulatory Guide 175 *Licensing: Financial product advisers – Conduct and disclosure* (RG 175) includes guidance on how advisers comply with section 961B(2)(g), specifically paragraphs RG175.334-RG175.339.

We advise that what advice providers need to do to show that they have satisfied section 961B(2)(g) varies depending on the surrounding circumstances. It includes:
explaining clearly to the client the advice service that is and is not being provided;
if the scope of advice is limited, ensuring that this is in the best interests of the client and does not exclude any critical aspect of advice,
if the advice includes a product recommendation, providing related strategic recommendations that benefit the client;

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depending on the subject matter of the advice, specifying in the advice that the client should review any decision made about financial products on the basis of the advice provided; offering to provide advice or referrals on any other key issues identified by the advice provider within the subject matter of the advice sought by the client.

Regulatory Impact Statement/Advice to Government

1606. Official witnesses are not meant to be asked to give opinions on matter of Government policy. The requested advice or memos substantially consist of such opinions. Accordingly it would not be appropriate to provide them to the Committee.

Best Interests Duty Changes

1607. Any statutory obligation imposed under Part 7.7A is in addition to any other obligation to which the person is subject to under the Act or any other law (s 960B of the Act). The reference to "any other law" includes the general law; a financial adviser may be under obligations under the general law eg a financial adviser may owe fiduciary obligations to their client.

ASIC is of the view that, although the content of statutory obligations and general law obligations may have common elements and it may be the case that the conduct of a person may both breach of a statutory obligation and a fiduciary obligation, the statutory and fiduciary duty nonetheless remain separate and distinct obligations that co-exist with each other.

Their separateness is perhaps best understood by understanding who has the power to enforce the obligations/duties and what remedies/sanctions apply if they are breached. Generally speaking:

statutory obligations are enforced by the regulator; fiduciary obligations are enforced by the person to whom the fiduciary obligation is owed;

the consequences of breaching a statutory duty (eg administrative banning; civil penalty) are different to a breach of a fiduciary duty (eg account of profits);

a person cannot contract out of a statutory obligation; a fiduciary can ratify a breach of fiduciary duty.

1608. As the Regulator, we focus our surveillance activities on breaches of the statutory obligations as they fall within our jurisdiction.

However, we can make the following general observations:

The fiduciary duty only arises in some circumstances. It is not one of the automatic categories of fiduciary duty – whether it exists will depend on the facts of each individual case.

As stated above, it is possible to contract out of the fiduciary duty.

1609. The imposition of a statutory best interests duty (s961B(1)) coupled with statutory safe harbour steps (s961B(2)) might be a less onerous duty than a fiduciary duty under the general law, but this does not necessarily create tension in the law or the risk of legal uncertainty. As stated above, the statutory duty is an additional, separate duty. The safe harbour steps will mean that the financial advice provider has satisfied the statutory duty - it removes the statutory consequences that might otherwise have followed from a breach of the statute. However, the satisfaction of the safe harbour steps does not of itself mean that the provider has satisfied their fiduciary duty. To the extent that there is uncertainty in relation to the fiduciary obligations of financial advisers to their

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clients, Part 7.7A has neither decreased or increased that uncertainty because it does not purport to affect any fiduciary obligations that might apply.