Governance Institute of Australia

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

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

Dear Committee

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

Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members are all involved in governance, corporate administration, company secretarial practice and compliance with the *Corporations Act 2001* (the Act), within public listed and public unlisted companies, private companies, public sector agencies and not-for-profit organisations, with their primary responsibility being the development and implementation of governance frameworks.

Governance Institute of Australia welcomes the opportunity to comment on the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 (the bill) and draws upon the experience of our Members in providing our response.

General comments

The Future of Financial Advice (FoFA) regime was introduced to provide better protection for consumers of financial products and services — it arose in response to the 2009 *Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services* (the PJC Inquiry) which investigated the issues surrounding the corporate collapses of various financial service providers, such as Storm Financial and Opes Prime.

The PJC Inquiry itself noted that its role was to make necessary recommendations for legislative change or regulatory improvement to help guard against the occurrence of corporate collapses in the future and improve the quality of financial advice Australian consumers receive.[1] The PJC Inquiry noted, further, that it had formed the opinion over the course of the inquiry that it had 'sufficient broad and consistent evidence to justify making a series of carefully considered recommendations which are designed to enhance professionalism within the financial advice sector and enhance consumer confidence and protection.[2]'

[1] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p149
[2] Ibid at p150

The original FoFA reforms attempted to strike this balance by introducing further consumer protections while simultaneously requiring financial advisers to meet higher standards of care and skill.

The government has formed the view that the right balance was not struck, and the bill before the Senate Committee is aimed at redistributing the balance in order to ensure that financial advisers are not burdened with unnecessary compliance requirements.

The passage of the bill through the House of Representatives was subject to inclusion of the following in Statements of Advice (SOAs) which also have to be signed by the adviser and the client:

- The adviser is required to act in the client's best interests and to prioritise the client's interests.
- The adviser genuinely believes that the advice is in the client's best interests given their circumstances.
- Fees must be disclosed.
- A Fee Disclosure Statement will be provided annually for 'new' (that is, post-1 July 2013) clients.
- Details of cooling-off period.
- The client has the right to change their instructions.

We note that these are not new requirements but the requirements to state them in the SOA (with the exception of fee disclosure) and to have the SOA signed are. On this basis, they do not address the concerns expressed by this organisation and others that the bill weakens essential consumer protections.

The government has also announced a new public register of financial advisers.

The Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014 was introduced to give effect to these and other requirements, along with the requirement that any instruction to alter or review instructions must be in writing, signed by the client and acknowledged by the adviser, adding red tape to the process. The changes are included in the FoFA Streamlining Bill.

Key elements of the bill include:

- conflicted remuneration exemptions, including when passing on exempt remuneration, for general advice and low value performance bonuses
- extending the employee exemption by 1 year to 1 July 2015 (or 18 months after the nominal expiry date of the enterprise agreement)
- removing impediments to adviser movement
- changes to the best interests duty, and
- exemptions from opt-in notices and fee disclosure statements for existing clients.

Key concerns with the bill

Conflicted remuneration exemptions

Governance Institute is of the view that the bill reintroduces the potential for conflicted remuneration in connection to both personal and general financial product advice on superannuation and investments, which had previously been banned. It does this removing the ban on conflicted remuneration on general advice (see the bullet point on conflicted remuneration exemptions above). This measure potentially reintroduces commissions into the advice space, especially in connection to superannuation and investment products.

Governance Institute is of the view that commissions should not be permitted to be paid under general advice. We oppose the return of commissions on investments (including upfront or trail commissions), or in superannuation.

Furthermore, we are of the view that conflicted remuneration erodes public confidence in the financial system.

Removal of the catch-all provision (changes to the best interest duty)

Governance Institute understands the government's concern that the 'catch-all' provision in s 961B(2) of the Act seemingly renders the safe harbour unworkable for advisers due to its open nature. Nonetheless, we believe that the 'catch-all' also provides valuable protection for consumers.

In this regard, the bill effectively repeals the adviser's duty to act in the best-interests of the client, notwithstanding the inclusion in SOAs (which also have to be signed by the adviser and the client) that the adviser is required to act in the client's best interests and to prioritise the client's interests.

The removal of the 'catch-all' provision in s 961B(2) has the potential to create loopholes that allow financial advisers to once again receive sales commissions, ongoing fees, volume rebates and other incentives to sell a product. Such loopholes would see financial advisers being paid for the provision of conflicted advice that is not necessarily in the best interest of the consumer. It was this mischief that the recommendations of the PJC Inquiry sought to address. The Inquiry report was firmly of the view that a best interest duty was necessary to improve the minimum quality of advice in Australia.

Governance Institute recommends that rather than weakening this essential protection, the provision should clarify that the onus of proof rests with the person alleging the breach of this section so as to ensure that the honest and competent practitioner is not exposed to defending unreasonable actions. That is, a complainant seeking to utilise this section should be able to demonstrate that the financial adviser should reasonably have known about a particular circumstance, and they had disregarded it, or they failed to take reasonable steps to act in the best interests of the client based on the information available at the time.

Exemptions to the opt-in requirement for existing clients

The opt-in requirement requires financial advisers who have an ongoing fee arrangement with a retail client to obtain their client's agreement at least every two years to continue the ongoing fee arrangement.

The financial adviser is required to provide a renewal notice to the client which sets out the ongoing fee arrangement, as well as what will happen if the client elects not to renew the arrangement, or if they do not respond to the renewal notice. This provision provides a strong consumer protection and promotes better transparency and accountability for financial advisers.

While Governance Institute agrees that the opt-in provision creates an administrative burden for financial advisers, we oppose the exemptions to the opt-in requirement for existing clients, on the basis that they place the control over the advising relationship in the hands of the financial adviser and provide no capacity for the consumer to assess if the ongoing fee arrangement remains suited to their needs. This therefore removes a valuable consumer protection which was implemented to accord with the recommendations of the PJC Inquiry.

We are of the view that an alternative approach could be taken to ensure that a form of consumer protection remains in place.

Governance Institute recommends that the exemptions to the opt-in requirement for existing clients 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 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.

Such an approach, if adopted, eliminates the need for financial advisers to seek to obtain consent to continue to charge fees of the client. However, such an arrangement can only work if the client's attention is clearly drawn to their right to discontinue, and includes a requirement that this right cannot be satisfied in the small print of a substantial document. We recognise that clients can already choose to opt-out of arrangements with their advisers; however, we believe that the explicit requirement for such information to be contained in the renewal notice, and for that information to be clearly stated, provides clients with further clarity about their rights in relation to receiving financial advice. We note that such information might not otherwise be easily accessible for clients seeking to terminate their financial services advice.

We also note that the bill also does not contain provisions that cover those who have been provided advice in the superannuation and managed fund context previously. It is possible that advice has been provided to a client on a superannuation product or managed fund product and that trailing commissions have been continued to be paid for many years. Many clients will have forgotten who they dealt with and have likely not heard from their advisers on these products in many years, yet these advisers will continue to receive benefits from the individuals without any further work being required. Governance Institute believes that where ongoing trailing commission arrangements are in place and will be grandfathered under the existing legislation, there should be some requirement that every person whose funds are currently being reduced by ongoing trailing commissions, be reminded of those arrangements.

Potential for uncertainty for financial advisers and consumers

Alongside the introduction of the bill, the government has also initiated an inquiry into the Australian financial system (the Financial System Inquiry or FSI). Governance Institute notes that the nature of the amendments to the FoFA regime contained in the bill appear to be at odds with the objectives of the FSI.

The final terms of reference for the FSI explicitly include a statement that the inquiry will recommend policy options addressing 'the needs of users with appropriate financial products and services.' Furthermore, the executive summary of the FSI's interim report notes that 'Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice', and the FSI seeks further public submissions on policy options in relation to this and other matters.

The FSI is currently reviewing the 6,500 submissions it has received. Governance Institute believes that passing the bill prior to the release of the final report of the FSI is premature. It also risks the possibility that the reforms contained in the bill could become subject to further amendment within a short space of time, depending on any recommendations that the FSI may make. This will serve only to confuse both financial advisers and consumers.

Conclusion

Governance Institute recognises that the bill has been introduced to reduce the red-tape and compliance obligations created by the implementation of FoFA regime. However, we are strongly of the view that weakening key provisions without providing for alternative, adequate consumer protections effectively returns the financial advice regime to the pre-existing regulatory framework.

Yours sincerely

Tim Sheehy
Chief Executive