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Leaders in governance

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Exposure Draft - Corporations Amendment (Future of Financial Advice) Bill 2011

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

We are also an influencer and expert commentator on governance thinking and behaviour in Australia. Our Members are all involved in governance, corporate administration and compliance with the *Corporations Act 2001* (the Act). Our Members work in both public listed and public unlisted companies, as well as in private companies. We have drawn on their experience in providing our submission on the matters contained in the *Exposure Draft – Corporate Amendment (Future of Financial Advice) Bill 2011* (the exposure draft).

We welcome the opportunity to comment on the exposure draft

General comments

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

CSA commends the Future of Financial Advice (FOFA) reforms as an excellent initiative which, in principle, aims to protect consumers from disingenuous advisers in the financial products arena. As the outline to the explanatory memorandum suggests, reform to the financial planning sector should be structured to improve the 'quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interest of the adviser with the client and reduce conflicts of interest[1]'.

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

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

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

CSA further notes the Australian Securities and Investments Commission (ASIC) recently closed submissions on their consultation paper 164 entitled, *Additional guidance on how to scale advice* (CP 164) which 'gives guidance about how to scale personal financial product advice to retail clients'.

CSA believes that viewing the current exposure draft in isolation might result in disjointed legislation that does not accord with the information available to the public. For example, there may be unintended consequences arising from the interaction of the 'best interests' test in the proposed s961C of the Act and ASIC guidance based on consultation paper CP 164.

CSA notes that considering the potential consequences of the exposure draft, is also a function of discussion, debate and time. CSA has been extremely disappointed that the consultation for the exposure draft was released on 29 August 2011 with potential respondents given 15 business days to respond, which is clearly an inadequate amount of time in which to properly assess the ramifications of the exposure draft.

Furthermore, Treasury would be aware that these time frames do not accord with the recommendations of the Banks Report[2] and, in particular, the principle which requires effective consultations with stakeholders. CSA notes that the consultation period also does not accord with the government's own guidelines on consultation as found in Appendix C of the Department of Finance and Deregulation's *Best Practice Regulation Handbook (June 2010)*. This recommends a consultation period of between six and 12 weeks, depending on the significance of the proposal, citing the United Kingdom Government's Code of Practice on Consultation, which stipulates a minimum of 12 weeks for written consultation at least once during the policy development process.

The *Business Checklist for Commonwealth Regulatory Proposals*, which has endorsement from a number of leading professional associations, representing diverse stakeholder interests, furthers the principle of effective consultation and recommends that consultation periods be at least 30 days and longer for more complex consultations.

It is evident that this consultation does not meet these benchmarks, particularly in light of the potential diverse impact of the exposure draft.

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[2] Treasurer of Australia, *Report of the Taskforce on Reducing Regulatory Burdens on Business – Final Government Response,* Media Release, 15 August 2006

The problems with this are that a short time frame provides insufficient time to canvass views and generate discussion among stakeholders and industry professionals with relevant expertise. When stakeholders do not have sufficient time to review the proposed reforms and consider their impact, it cannot be said that effective consultation is taking place. The second concern is that short time frames may also lead to drafting errors in the proposed legislation.

CSA reiterates that adequate time is required to fully assess the implications of proposed legislative reform and provide informed comment.

Best interest obligations

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

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

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

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

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

In light of section 961P(2) which provides that an applicant has 6 years within which to bring an action, it is likely that the imposition of this section will be particularly burdensome. An advisor who provides personal advice about a financial product under section 961C(3) may well comply with s961(2)(a),(b)&(c) but not keep a written record of that advice. For a client to then commence an action some 6 years later places a very heavy burden of proof of the adviser, who, according to the prescriptive nature of these provisions will need to provide evidence that they have complied with the client's best interests.

CSA recommends that the length of the statutory timeframe for bringing an action should be variable depending on the complexity of the advice and products involved or otherwise clarified to protect simple financial products, including basic banking and general insurance products, where the adviser would be participating in numerous transactions on a daily basis. CSA notes that the

reform is not specifically targeted at simple financial products, yet the compliance regime for the provision of advice about these products is likely to increase for many entities.

CSA notes that the various state based Limitation Acts, which set out the limitation periods for bringing actions in different contexts, contain periods of varying length. The NSW Act, for example, imposes limitation periods from 1 year to 12 years depending on the circumstances. A variable scale in the context of financial advice would not be out of place.

Charging ongoing fees to clients

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

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

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

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

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

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

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

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

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

Enhancing to ASIC's licensing and banning powers

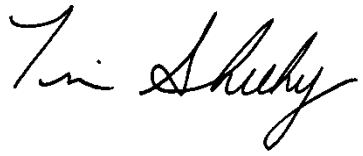
CSA agrees with the proposal to enhance ASIC's licensing and banning powers and does not wish to comment further on this part of the exposure draft and explanatory memorandum.

Conclusion

CSA strongly supports the implementation of the 'best interests' test and the provisions which encourage greater and better disclosure in the rendering of financial services. However, CSA also believes that the consultation does not take into account the wider implications of reform to the Act. The implications of the exposure draft can have wider reaching effect on financial services practices and potentially unintended consequences. CSA believes that the exposure draft asks more questions than it answers, and believes that Treasury should consider a wider and more in depth consultation.

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

Yours sincerely



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