

Dear Sir/Madam

I refer to the Government request for feedback and comments by interested parties on the options presented in the "*Wholesale and Retail Clients – Future of Financial Advice – Options paper – January 2011*" (the "**Paper**"). I am writing to provide my views in relation to the matters raised in the Paper.

## **BACKGROUND**

By way of general background, Halsey Legal Services is a law firm whose financial services practice has provided legal services to approximately 80 Australian Financial Services licensees since March 2002. In specific terms, Halsey Legal Services has, within the past six months alone, acted as an advocate for both AFS licensees and external compliance consultants in relation to contentious matters with ASIC regarding section 761GA.

It is not my intention to provide a comprehensive response in relation to all of the matters raised in the Paper, but rather to comment upon a number of issues raised in the Paper and to highlight the necessity of the retention of the provisions of section 708(10) and section 761GA of the Corporations Act 2001, although with some suggested amendments to the latter section.

## **COMMENTS IN RELATION TO CERTAIN ISSUES IN THE PAPER**

I appreciate that the thrust of the Paper relates to Treasury's consumer protection responsibilities. It is self-evident that the majority of the public tend to be relatively unsophisticated and unskilled in financial services matters, and that the existing range of consumer protection measure prescribed for them as "retail clients" provides the public with significant benefits.

However, I am concerned about what appears to be the lack of balanced commentary (by Treasury) in the Paper relating to

- firstly, the significant economic benefits provided to society by the non-retail client segment of the financial services market, and
- secondly, the innate public good in allowing the more sophisticated and informed segments of the client market a greater level of flexibility and freedom in their financial arrangements.

Non-retail clients have provided and continue to provide a very important source of entrepreneurial capital for small businesses and ventures, through "wholesale" financial product offerings. This is particularly true in relation to small property syndicates and small development syndicates. Over several decades, these financial product offerings have typically been (and continue to be) subject to significant client demand, and have typically been successful and financially rewarding for the non-retail clients. They have resulted in many hundreds of successful developments and successful investment returns across the country and provided significant employment to skilled and semi-skilled workers in the construction and building industry. Importantly, it has also fostered a more entrepreneurial spirit in a segment of society, rather than a spirit of regulated and protected dependency.

In addition, I believe that it is a fundamental right for individuals to request that they be dealt with on terms other than the highly structured and highly regulated basis upon which the average "retail client" obtaining standardised services offerings are required to be dealt with under Chapter 7 of the Corporations Act, provided that the individual gives their informed consent. The question of informed consent is dealt with in greater detail below.

There is significant demand, by the more sophisticated and informed segments of the society, to have greater control and customisation of the services offered to them, and a greater variety of product offerings. By way of example, such a demand is evident from the demand for services such as self-managed superannuation funds.

## **NEED FOR THE RETENTION OF SECTION 761GA**

There is a strong libertarian argument to ensure that any government, no matter how well-meaning, does not unnecessarily remove the rights of people to choose participate in products and services.

This is equally true if the removal of these rights arises from the introduction of some form of arbitrary financial limits, such as the size of their investment, the level of their income and wealth. Yet, unfortunately, this was the effect of the arbitrary limits in section 761G of the Corporations Act 2001.

The introduction of section 761GA of the Corporations Act 2001 as a consequence of the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* was an important reform. Part of the rationale for the reform is as relevant today as it was when the law was introduced. Namely:

*“ ... there are some investors who are defined in the legislation as retail investors and are unable to access wholesale status. For reason such as experience or professional training, these investors may wish to be treated as wholesale investors. Such investors may consider retail disclosure as unnecessary hindrance to activities they well understand and would prefer to access wholesale investor status. They may also wish to access wholesale only products.”*

In other words, section 761GA removed the artificial and arbitrary financial limits that were contained in section 761G relating to the so-called deeming of persons to be non-retail clients by virtue of the size of their investments, or the level of their income and wealth.

Conversely, the deeming provisions in section 761G had the potential to create perverse outcomes where people were treated as non-retail, not because they provided their informed consent and were sophisticated and knowledgeable, but because they fell within the arbitrary limits relating the size of their investments, or level of their income and wealth. An example of this was an unsophisticated client who received a substantial inheritance.

There is a strong argument that only informed clients who knowingly and willingly give up the protections of being retail clients should be allowed to be treated as non-retail clients. Informed consent can only occur in circumstances where the clients are made aware of the consequences of their choices and actions. The consequences should be set out to the client in plain English, and the client should be required to provide written consent to being treated as a non-retail client with full knowledge of those consequences and in spite of those potential consequences.

## **INFORMED CONSENT**

In that context, it may be arguable that the current arrangements as set out in section 761GA do not adequately provide for that level of informed consent.

Section 761GA states that a client will not be treated as a retail client if, among other things:

In sub-section 761GA(d), the financial services licensee is satisfied on reasonable grounds that the client has previous experience in using financial services and investing in financial products that allows the client to assess:

- (i) the merits of the product or service; and
- (ii) the value of the product or service; and
- (iii) the risks associated with holding the product; and
- (iv) the clients' own information needs; and
- (iv) the adequacy of the information given by the licensee and product issuer

In sub-section 761GA(e) the licensee gives the client before, or at the time when, the product or advice is provided a **written statement** of the licensee's reasons for being satisfied as to those matters.

In sub-section 761GA(f) the client signs a **written acknowledgment** before, or at the time when, the product or service is provided that they have not received the documents usually provided to retail clients, such as product disclosure statements (PDSs) etc ... and, in sub-section 761GA(f)(iii) that the licensee does not have " ... *any other obligations to the client under the Chapter ...*"

The issue is – what is the client to make of the statement in sub-section 761GA(f)(iii)? Does a client actually provide informed consent in relation to giving up the status of being a retail client?

Any perceived weakness in this regard can be overcome by sub-section 761GA(f)(iii) being **redrafted** to state that the client must sign a consent that the client waives the rights and consumer protections that come with being a retail clients, including but not limited to:

- not obtaining a Financial Services Guide from their financial services provider, which sets out the range of services that the financial services provider can provide them;
- not obtaining a Statement of Advice setting out the nature and specifics of the advice being provided by the financial services provider;
- not obtaining a product disclosure statement from the financial services provider, which contains information about the product they are acquiring;
- not being able to access a free ASIC-approved independent external dispute resolution scheme in case they have a complaint against their financial services provider;
- the possibility that their financial services provider may not have the ASIC-prescribed level of professional indemnity insurance to meet customer claims; and
- the possibility that the staff of the financial services provider may not meet the ASIC-prescribed training and qualifications benchmarks.

On page 23 of the Paper, there is a suggestion that there may be an argument against the use of section 761GA in distinguishing between retail and non-retail clients because it involves the financial services provider considering and documenting the individual circumstances of each client. This seems odd and does not seem to pass the logic test. In the event that the financial services provider is not able to classify the client as "non-retail" under section 761GA, section 945A of the Corporations Act 2001 would appear to require the financial services provider to spend considerably more time and effort (and documentation) on an ongoing basis in providing services to the client because these are typically the obligations in relation to a retail client.

## SUMMARY

In summary, there is a strong case for the retention of the status of the non-retail client. The retention of section 761GA test in distinguishing the difference between retail and non-retail clients. The test should not be, as it currently is not, the subject of any "financial qualifiers" - such as the size of the sum to be invested, or the client's income and wealth levels. The only issue for consideration should be that the client is sufficiently sophisticated (within the meaning of section 761GA(d) and sufficiently informed (within the meaning of section 761GA(e) and (f))). The wording

of section 761GA(d) appears sufficiently strong because it contains both a subjective test (the licensee – financial services provider’s documented views in their written statement provided to the client ) as well as an objective test – that this view be based on “reasonable grounds”.

However, in ensuring the concept of “informed consent” is adopted in practice, the wording of section 761GA(f) should be amended to include the information that I have referred to above.

I would be happy to discuss this submission further should Treasury consider it appropriate.

Yours sincerely

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