Stockbrokers Association of Australia
Incorporating SDIA

Corporations Amendment (Future of Financial Advice) Bill 2011 -

Submission -

20 September 2011

Executive Summary

The Stockbrokers Association welcomes the **decriminalising** of the obligation to have a reasonable basis for personal advice to retail clients.

However, we would like to comment and raise concerns regarding the following aspects of the Bill, some of which may limit the availability of advice to retail clients –

Best Interests Obligation

- 'subject matter of advice' and arrangements where 'different' subject matter may be appropriate are concepts that are too wide and unworkable;
- the ability of advisers to rely on expert third parties for product - recommendations should be retained in the existing form; -
- tailored, limited advice may not be facilitated by the Bill;
- business models which use Authorised Representatives may need to be - reviewed; and -
- existing obligations of market participants often exceed those proposed, so there is a need for clarity;

Opt-in obligation

- the opt-in obligation should be confined to arrangements for the giving of advice, and not to other financial services; and
- the consequences of a client's failure to respond to an opt-in request ought to be covered;

Expanded ASIC powers

- while the provider (individual or firm) is responsible for their own actions, we fail to see why the new definition of 'provider' is required. ASIC already has sufficient powers against individuals; and
- we fail to see why the power to take action against someone 'likely to breach' requirements is necessary. Once again, the existing ASIC powers are sufficient.

Introduction

The Stockbrokers Association of Australia is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, ranging from the largest wholesale stockbroking firms to medium-sized firms, and down to the smallest firms, having mainly a retail client base.

The Stockbrokers Association is pleased to provide this submission to the Government on the *Corporations Amendment (Future of Financial Advice) Bill* (the **'FOFA Bill'**).

We note that one of the aims of the Bill (as expressed in Minister Shorten's announcement of 29 August) is to restore trust and improve the availability of advice to investors –

> *'It is a concern that only one in five Australians access financial advice. These reforms will restore trust and confidence in the sector following collapses such as Storm, Westpoint and Trio. They also remove the red tape that has prevented low-cost, good quality advice being delivered to millions of Australians.'*

The activities of stockbrokers are far removed from those of Storm, Wespoint and Trio, which led to the wholesale review of financial services in Australia. Stockbrokers would like to think that there is already a relationship of trust with their clients. This is borne out by the fact that in 2010 complaints to the **Financial Ombudsman Service** about stockbrokers **fell** by **75%**.

In this Submission we will concentrate on the **Best Interests obligation**, but will also comment on the **Opt-in obligation** (for Ongoing Fees) and the **Enhancements to ASIC powers**.

Finally, we inquire as to the progress of other aspects of the FOFA reforms.

A. Best Interests Obligation

The new obligations in the FOFA Bill **replace** the old 'know your client/know your product' obligations. Section s945A (requirements to have a reasonable basis for advice) and s945B (limited information warning) are repealed and replaced by s961C and s961J respectively, as well as the other provisions of the new Sub Division B.

We are pleased to see that the new best interests obligation is to be a **civil penalty provision** and is therefore **decriminalised.** As the Association has stated for a number of years[1], it is anomalous and disproportionate that breaches of s945A&B were made serious criminal offences by the financial services reforms which came into effect in 2004.

1. 'Subject Matter' of advice & where different subject matter may be appropriate

The new Section s961C(2) sets out the steps you must take to act in client's best interests. - It is a very wide, 'non exhaustive' list, so in particular situations there could be other factors. - The '**subject matter**' of advice is not financial product specific; it could be anything (e.g. - securities, unlisted product, real estate, etc). -

Under Section s961C(2)(d) where it is '**reasonably apparent**' that another 'subject matter' - could better achieve the client's objectives, the adviser must inform the client **in writing**. - What determines 'reasonably apparent' is an **objective test** of what would be *apparent to a person with a reasonable level of expertise in the subject matter*: s961D. -

Issues: -
We see the following issues with the above provisions -

a. - ***Subject matter of advice****:* The concept of *subject matter of advice* is **too wide and unworkable,** and is contrary to the stated policy objective the Government and ASIC of facilitating limited advice (see **3. Scaled Advice** below)

b. - **Objective test of 'reasonably apparent'**: the assessment in s961D should be subjective, not objective. The assessment should take into account the information and knowledge that was or ought to have been available to the adviser. To apply an objective test will open to the floodgates to a wave of litigation and FOS hearings, where clients have the opportunity to completely review and revisit any advice that they received, and with the benefit of hindsight. The law must not allow this. Any review of advice must be solely based on **what was reasonable in the circumstances**.

c. - ***Further Advice*** **and the 'other subject matter' notification:** the notification to the client that some other subject matter may be appropriate should take into account the fact that personal advice is not always given in writing. Stockbrokers often give *Further Advice* which is permitted by the Act[2], and need

[1] For example, in our Submission to the Government's *Review of Sanctions for Breaches of Corporate Law* dated 6 June 2007
[2] *Further Advice* is permitted by Section 946B, as amended by Regulation 7.7.10AE in 2005

not be committed to writing. Accordingly, for Further Advice the notification should not be required to be given in writing. The impact of the new notification on Record of Advice requirements under the Further Advice provisions also needs to be clarified. There are also concerns that these reforms may result in significant increases in Record of Advice detail[3].

d. - **Timing of '*other subject matter*' notification**: there is no time specified for the 'other subject matter' notification to be given, which could lead to uncertainty.

2. Reliance on another individual for product investigation and assessment

Section 961C(g) requires 'the provider' (i.e. the individual adviser who provides advice) to either:

- conduct a reasonable investigation into the financial products that might achieve the client's objectives and assess the information gathered in the investigation, OR
- if another individual has made such an investigation and the provider has access to the results of the investigation – assess the information gathered in the investigation.

Where an individual representative relies on research or an approved list provided by their employer, this clause appears to require them to be able to put themselves in a position to 'second guess' that research. In relation to product research, it would be unduly burdensome and practically impossible for all advisers to have access to the entire research that went into a product recommendation. In stockbroking, major resources are spent in either employing research analysts to assess products, or obtaining expert research from third party providers. In traditional stockbroking, there are expert analysts who research listed companies, in order that a recommendation ('general advice') as to their securities (e.g. 'buy', 'sell' or 'hold') can be produced. The adviser is then able to concentrate on ensuring the advice or product is suitable for the client. The current law on general advice (s949A - which is not changing) anticipates such an arrangement, ensuring that – while the product recommendation must be soundly based - the client is warned that it may not be appropriate for their circumstances. Quality research is a key part of the business of broking, and stockbroking firms go to great lengths and expend large resources in its production. Authorised representatives have the benefit of being able to rely on information received from their licensee. However, the new provisions are unclear on the liability (if any) of an individual employee representative who relies on research provided by their licensee. **The individual adviser ought to be able to rely on product research provided by their licensee, without having to second-guess or revisit it.**

3. Scaled Advice

In 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

[3] For example, see Regulation 7.7.09, which already requires 'switch advice' detail to be summarised and to acknowledge certain statements having been given

that the Explanatory Memorandum to the FOFA Bill appears to accommodate such clients and their limited requirements -

> 1.29 These requirements are 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 situations where limited advice has been requested by the client the adviser is able to **tailor** the information they obtain about the client solely to what is necessary to provide that form of advice. However, the adviser is required to exercise professional judgement and advise the client if they believe advice on another subject matter could better meet the client's needs and objectives. This reflects the fact that retail clients may not always know what type of advice will meet their needs and objectives. (emphasis added)

ASIC is also working to facilitate tailored or scaled advice. In a recent Consultation Paper[4], ASIC sought to provide additional guidance on how to 'scale' advice. By way of background to the guidance, ASIC noted that a recent survey found that **one-third** of Australians prefer scaled or 'piece-by-piece' financial advice rather than comprehensive or 'holistic' advice.[5] (Our Members would suggest that if this survey were solely conducted in **stockbroking**, the figure would be significantly **higher** than one-third.)

It is encouraging to see that the Government and ASIC are taking measures to facilitate the type of service that a growing number of clients want. However, our Members are concerned that certain aspects of the FOFA Bill will have the unforeseen consequence of actually **discouraging** such tailored or scaled advice. As discussed above, much of this results from the breadth of the concept of **'subject matter of advice'** in the new provisions, but it is also exacerbated by the removal of key concepts from the existing legislation.

a. Removal of the concept of 'Relevant Personal Circumstances'

With the repeal of Section 945A (Requirement to have a Reasonable Basis for Advice), the following processes are also repealed:

- determining the ***Relevant Personal Circumstances*** in relation to the Advice; and
- making reasonable enquiries of the client to get personal information concerning the Relevant Personal Circumstances.

This language has always anticipated the scalability of Retail Personal Advice. Unfortunately, scalability is far less obvious in the Bill's Section 961C (Provider must act in the best interests of the client).

It is also of concern that there is a drift in emphasis away from what the client *is requesting*, to what the client *may need* in terms of advice. Section 961C requires the provider to identify both the objectives, situation and needs of the client that are disclosed, and the subject matter of the advice requested. The requirement to identify the 'needs' of the client could be read as unrelated to the advice requested. The profiling obligation (Section 961C(2)(c)) links to the information disclosed by the client, not the Advice requested.

[4] ASIC Consultation Paper 164 *Additional guidance on how to scale advice* July 2011 ('CP164'). The Guidance does not take the FOFA Bill into account.
[5] CP164.1

This removes some flexibility for the adviser in being able to shape in the first instance the scope of profile information necessary to ensure a reasonable basis for limited personal advice, to one where the adviser is obliged in the first instance to discern what advice might be required by the client from the personal information disclosed to the adviser.

The concept of Relevant Personal Circumstances is a useful one for advisers and their clients. It fosters scalability and adds relevance to advice and to the service that clients demand. **It should therefore be retained in the new legislation.**

The removal of the term 'Relevant Personal Circumstances', also has consequences for other provisions outside Section 945A where it is used. In particular, the term is used in:

- Condition 57(b) of PF 209 (Relevant Personal Circumstances information related to Retail Personal Advice triggering a SoA must be archived for 7 years);
- for an Initial SoA to establish properly a Further Advice/RoA relationship, the Initial SoA must include Relevant Personal Circumstances information (Reg 7.7.10AE). Note: The Basis for the Personal Advice (not a reiteration of Relevant Personal Circumstances information) must be included in SoAs prepared by AFS Licensees (Section 947B) and Authorised Representatives (Section 947C);
- in the context of MDA Services (CO 04/194), the Investment Program accompanying the MDA Contract must include the basis on which the MDA Operator considers entering the MDA Contract to be suitable for the client's Relevant Personal Circumstances [Paragraphs 1.16(b) and (c)(iii)(A), 1.18], and in relation to Review of the Investment Program, ongoing suitability must be considered in light of the Client's Relevant Personal Circumstances [Paragraphs 1.19 and 1.20 of CO 04/194].

4. Professional Indemnity Insurance – ASIC RG 126 (Compensation Arrangements)

Given the introduction of the concept of 'Provider', even though Civil Liability is to remain with AFS Licensees and Authorised Representatives, the regulatory risk (in terms of the possibility of Banning) faced by Representatives providing Retail Personal Advice will increase. This may lead to higher premiums if there is the need to review Retail Compensation/PI Insurance arrangements to cover Representatives.

5. Incentive to revert to 'representatives'

In stockbroking, two models apply in relation to representatives: some Market Participants have appointed all their Advisers as Authorised Representatives, while most have taken best advantage of Section 910A(a)(iv) and appointed very few or no Authorised Representatives.

Those who have networks of Authorised Representatives may face requests from Authorised Representatives to revert to 'Representative' status. This would remove the need for tailored FSG/SoA formats for the Authorised Representative, and importantly, would mean that the former Authorised Representatives avoid the new civil penalty provisions that would have applied to them personally.

The potential ramifications should be considered. ASIC would be likely to be forced to take a hard-line on the interpretation of Section 910A(a)(iv), in order to protect the utility (to ASIC) of having Authorised Representatives providing Retail Services.

6. Relevance of other Market Participant Obligations

Market Participants are already subject to a number of obligations which are relevant to the *FOFA Bill's* Best Interests obligations. This is not acknowledged in the Bill. For the avoidance of doubt and confusion, the new obligation should be made subject to other obligations under the AFS licence (e.g. general obligations under s912A), and the special obligations under the *ASIC (ASX Markets) Market Integrity Rules*, which already seek to ensure that brokers act in the client's best interests.

Some of the existing obligations under the Market Integrity Rules relevant to acting in a client's best interests are as follows[6] -

- restrictions and special disclosures on giving advice in particular situations,
    - when acting for offeror in Buy-Back or Takeover (Rule 6.3.1), and
    - when in possession of price sensitive information which may prejudice another client (Rule 3.6); and
    - when selling an underwriting shortfall (Rule 5.10.5)
- Client Order priority (Rule 5.1);
- Principal trading (Rule 3.2);
- Staff Trading (Rule 5.4);
- Unprofessional Conduct (Rule 2.1.5); and
- Good fame and character requirements (Rule 2.1.4).

Stockbrokers are already under comprehensive common law and regulatory duties to act in the client's best interests. **We seek clarification as to how these existing provisions will fall within the new regime.**

[6] In setting out these Market Integrity Rules, we note that certain of these obligations are also found in the *Corporations Act*, e.g. client order priority (s991B), principal trading (s991E), and staff trading (s991F).

B. Opt-in for Ongoing Fees

We wish to raise concerns in two areas:

1. - **Too Broad:** one of the cornerstones of the FOFA reforms is the removal of conflicted remuneration for advice. Accordingly, the application of the new provisions in s962A(1) to 'financial services' is too broad. The ongoing fee should be connected to 'financial product advice', not more widely to 'financial services' as it is in the Bill.

2. - **Failure by Client to agree**: there is concern that the Bill does not address the consequences of the Client not agreeing to Opt-In. Clients are notorious for not signing and returning Agreements/Forms. What duties remain on the Provider if a material 'portfolio' event occurs at around the time the Provider is no longer able to charge on-going Personal Advice fees? Is the Provider expected to contact the client to 'Warn' of developments, and to charge an 'episodic' fee? Would the client have recourse to the Provider/AFS Licensee if reasonable service expectations are not met? For the sake of certainty for Retail Clients and Providers, the legislation should not be silent on this scenario.

C. Expanded ASIC Powers

We wish to raise concerns in two areas:

1. - ***Provider*:** the new definition of 'provider' makes the individual who gave the advice responsible for the advice. Legally, while the Licensee or the Authorised Representative is still legally liable for the advice, the expanded 'Provider' definition is designed to make it clear that ASIC can take action against the individual (e.g. by way of banning order), as well as civil penalty action (or civil recovery by the client) against the Licensee or Authorised Representative. In seeking these powers, ASIC appears to want absolutely no doubt about its ability to take action. We fail to see why ASIC's existing powers are not sufficient in this regard.

2. - ***Likely to breach***: ASIC's powers are to be expanded so that it can ban people if they are *likely to breach* requirements. As with the addition power over providers above, we fail to see why this is really needed, and would argue that ASIC's existing powers are sufficient.

D. Other FOFA matters and consultations

Finally, we look forward to further detail about other aspects of the wider FOFA project, in particular –

- the application of the FOFA **remuneration reforms** to **stockbroking**, which the Minister stated on 29 August 'will not be unduly impacted';
- the review of the **definitions of 'retail' and 'wholesale'** investors[7], and
- the result of Mr St John's inquiry into **compensation arrangements**[8].

We are once again grateful for the opportunity to raise these matters with the Government in the process of the enactment of these important matters of policy and law reform, and for the continuing dialogue with Treasury and ASIC officers.

We would of course be happy to discuss further any of the matters raised in this Submission.

STOCKBROKERS ASSOCIATION OF AUSTRALIA
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[7] FOFA Options Paper *Wholesale and Retail Clients* 26 January 2011
[8] FOFA Consultation Paper *Review of compensation arrangements for consumers of financial services* April 2011