Exposure Draft

Corporations Amendment (Future of Financial Advice) Bill 2011

Submission to Treasury

September 2011

21 September 2011

Mr Richard Sandlant
General Manger, Retail investor Division
C-/ The future of Financial Advice
The Treasury
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Dear Richard,

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

The Association of Financial Advisers Limited (“AFA”) is a professional organisation that has been serving the financial advising industry for over 60 years. Its aim is to provide members with a robust united voice, continually improved practices and focus firmly on the exciting, dynamic future of the financial advising industry.

With six decades of success behind it, the AFA’s ongoing relevance is due to its philosophy of being an association of advisers run by advisers. This means advisers set the agenda, decide which issues to tackle and shape the organisation's strategic plan.

The AFA’s key strategic priorities are as follows:

1. Clearly define and position the role of the Financial Adviser
2. Significantly increase consumer literacy and education
3. Continue to improve education requirements for advisers
4. Ensure that disclosure documents meet the “clear, concise and effective mantra” of the Financial Services reform (“FSR”)
5. Significantly address the “under insurance” problem in Australia
6. Increase the Superannuation Guarantee (“SG”) levy beyond 9% to 15% via a range of strategies
7. Ensure that the market place remains robust for all participants in the financial services sector.

The AFA thanks Treasury for the opportunity to provide comments on the Exposure Draft – Corporations Amendment (Future of Financial Advice) Bill 2011 (“Tranche 1 Bill”). The AFA supports the Government’s objective to see more Australians access financial advice; this is in keeping with the policy intent of the Future of Financial Advice (FoFA) Reforms.

This submission has been prepared by the AFA on behalf of its members and in response to the Tranche 1 Bill. This submission provides comments and recommendations on the following:

1. Best Interests obligations
2. Charging ongoing fees to clients
3. Enhancements to ASIC’s licensing and banning powers.

Our submission aims to provide you with an overview of what we consider to be the main issues concerning our members, contained within the Tranche 1 Bill.

Should you have any questions, please do not hesitate to contact me on (02) 9267 4003.

Yours sincerely,

Richard Klipin
Chief Executive Officer
Association of Financial Advisers Ltd

Best Interest Obligations

The best interests duty imposes a new statutory standard of care which is aimed at ensuring that all clients receive personal advice that is appropriate to their needs. Under the proposed amendments to the Corporations Act 2001 (“Act”), advisers will have two distinct obligations when giving personal advice to retail clients, namely to:

(a) act in the best interests of the client; and

(b) prioritise the client’s interests in case of conflict with the adviser’s interests.

Definition of reasonably apparent (section 961D) and reasonable investigation (section 961E as affected by section 961G(3))

In order to act in the best interests of the client, the adviser is required to adhere to several minimum steps, which include:

1. undertaking reasonable investigations where it is reasonably apparent that information is incomplete or inaccurate;
2. where it is reasonably apparent that the client should get advice on another subject matter, warning the client in writing; and
3. where an approved product list is used and it is reasonably apparent that there is no product on the list which meets the client’s needs, the adviser not recommending a product from the list.

The definitions of ‘reasonably apparent’ and ‘reasonable investigation’ are important, because among other things they qualify the adviser’s obligations in situations where there is an ‘approved list’, or where the adviser is providing advice on limited issues (scaled advice). The current definitions do not provide sufficient clarity to guide practical application for advisers.

The AFA seeks further clarification on the meaning of ‘reasonably apparent’ and ‘reasonable investigation’.

Required Steps for Acting in Best Interest

Section 961C of the draft legislation states that “The steps that the provider must take in acting in the best interests of the client include …” the steps outlined in the draft legislation, hence these steps are in some way the minimum required to demonstrate acting in the best interests of the client. However, we note that the draft legislation also states that the required actions of an adviser may not be limited to these steps. The draft legislation lacks an adequate overarching definition of what will, and will not, constitute the best interests of the client in order that advisers are able to comply with the requirements.

On the basis of this draft section, should an adviser not complete one or more of these steps, then this will constitute a breach of the legislation. Conversely, an adviser that completes all of the required steps will not guarantee meeting the requirement to act in the best interests of the client.

It is the view of the AFA that the introduction of the draft legislation is an opportunity to clarify the requirements of advisers and provide guidance to them in order that financial services are provided in a clear, efficient and appropriate manner and that in order to do this, further clarity is required of the draft legislation.

Best Interest Obligations

Priority of the Client's Interest

Sections 961K and 961L refer to the obligations with respect to prioritisation of the interests of clients in the context of a conflict of interest. Conflicts of interest will exist in many cases, simply due to the application of fees. In this context there is no clarity as to what this obligation might mean from the advisers perspective. Whilst it is expected that guidance on this will be provided later as part of the applicable Regulatory Guide, it is considered sufficiently important that greater clarity is required at the legislative stage.

Approved Product Lists

Section 961G, seeks to define Approved Product List (APL) and to place obligations on the adviser with respect to these APLs. In reality, many licensees currently operate a non APL Approval process, where an adviser can seek approval from their licensee to recommend a product that is not on the APL, where the non-APL product better meets the needs and objectives of the client. Non-APL approval processes are not adequately addressed by the legislation and this may cause uncertainty for advisers.

The AFA is concerned that these new obligations may, in effect, cause difficulty in terms of an adviser recommending a product that is not on the APL, resulting in advisers avoiding providing advice, rather than recommend a non APL product.

Scalable Advice

The AFA is concerned that the new Best Interest obligations will make it more difficult to provide scalable or limited scope advice and that this is contrary to the FoFA objective of improving access to advice.

Charging Ongoing Fees to Clients (Opt-In)

The AFA Opposes Opt-In

The AFA strongly rejects the need for Opt-In and asserts that the objective is already addressed by the removal of commissions and the introduction of best interests. The way that the Opt-In proposal has been defined is extremely complex and will have significant impact upon advisers in terms of cost, process change and unnecessary additional stress.

In the items raised below, we have set out our concerns with the way this legislation is drafted.

Inconsistency with Best Interests Duty

As currently drafted, the 'Opt-In' requirements apply to Australian financial services licensees and authorised representatives that provide general and personal advice and have ongoing fee arrangements. This is in contrast to the best interests duty that only applies to people providing personal advice. There is a concern that the current draft legislation has wider ambit than initially intended. It may potentially apply not only to financial advisers and planners but also to other players in the industry such as product issuers that provide general advice and have ongoing fee arrangements.

Grandfathering in the Context of Sale of a Business or Client Book

Section 962(3) appears to set out the grounds under which a client would be excluded from the Opt-In obligations on the grounds of being a pre-commencement client. An interpretation of this section might suggest that a client would retain the pre-commencement exclusion if they were transferred to a new adviser as long as they remained with either the same Licensee or the same Authorised Representative. This is a particularly important point and requires clarification.

The AFA recommends that clients who are classified as pre-commencement should remain pre-commencement in all circumstances related to the sale of a business or movement from one licensee to another. Where there is an existing contractual relationship, and the rights can be transferred, this should continue to be treated as pre-commencement.

Ongoing Fees Caught Under Section 962

There is insufficient clarity with respect to which fees need to be included in the fee disclosure statement and renewal notice. Based upon a current reading this could include fees for products such as Life Insurance, which are not otherwise impacted by FoFA and other incidental fees.

It is the AFAs view that these obligations should be limited to financial products and services directly impacted by FoFA.

Obligation to Refund Fees Under Section 962C

Section 962C includes a requirement for the adviser to refund fees, on the clients request, if the adviser has failed to meet either the fee disclosure obligation or the renewal notice obligation, within the required timeframe. This directly relates to the obligation on the adviser to give the client a fee disclosure statement at least 30 days before the disclosure date or to send the client the renewal notice at least 30 days before the renewal notice day. Breaches of the obligations under Section 962D and 962G will come in two forms – either not providing the statement/notice at all or providing the statement/notice late. The severity of these two matters is very different. Importantly there is also a need for clarity on the distinction between "give" and "send" as it applies to Section 962C. The AFA is concerned that Section 962C does not provide any means for the adviser to remedy a breach of the timeframes under Sections 962D and 962G. This potentially means that the client has an open ended right to reclaim fees for a timing breach that may have been many years prior.

The AFA is seeking clarity as to the ongoing implications of a timing breach and guidance on what an adviser needs to do to re-commence a fully compliant fee arrangement.

Charging Ongoing Fees to Clients (Opt-In)

Administration issues

The draft legislation requires that annual fee disclosure statements and renewal notices must be provided to clients. It is the view of the AFA that this process is overly prescriptive and will result in significant administrative issues. Further, the extent of change imposed by this legislation necessitates an extended timeframe for implementation.

The AFA has the following concerns with respect to the administration of this obligation:

- The disclosure date is defined as the anniversary of the day that the on-going fee arrangement was entered into. However there are a range of possibilities that could be used for defining this date, including the date the Statement of Advice was presented, the date that the client agreed to proceed with the advice or the date that the client signed the product application form.
- The requirement to provide the fee disclosure statement and renewal notice at least 30 days prior to the anniversary date means that the adviser will have a maximum of 10 months data on actual fees. This will result in either problems with what is reported or significant additional complexity.
- Many advisers will seek to present the fee disclosure statement and the renewal notice at their annual (or 6 monthly) client review. The requirement to provide these documents at least 30 days prior to the anniversary date will mean that reviews will need to be undertaken at 11 month intervals rather than 12 monthly.
- Where a client does not respond to a renewal notice prior to the disclosure day, Section 962K asserts that the arrangement is terminated. Should the client be simply a few days late in responding, this would imply that the adviser and client would need to agree to a totally new fee arrangement, which in reality could only be done by providing a new Statement of Advice. This is a very significant cost and imposition for a late response.
- With respect to the requirement to disclose the expected fees for the following 12 months, there will be a number of potentially unknown factors that will impact upon this number, such as likely and possible additional contributions, likely and possible withdrawals, along with market movements. There is no clarity on the extent to which an adviser needs to investigate all these matters in the process of preparing the statement/renewal notices.

Additionally we note that the draft legislation implies that the client will be able to immediately terminate the fee arrangement at anytime. Under this requirement and in the context that there is likely to be a dependency upon a number of external product providers, it will be particularly difficult for the adviser to implement all the actions required to terminate existing fee arrangements immediately. It would seem more appropriate that the adviser was given 30 days in which to make these arrangements.

Written notice

It is the firmly held view of the AFA that the Opt-In provisions are overly onerous on advisers. The Opt-In notice is explicitly required to be provided in ‘writing’. To this end, we note that advisers frequently use a wide range of communication mediums with clients including telephone, email, sms etc. We further note that the explanatory memorandum to the draft legislation states that:

> *In terms of clients notifying the fee recipient in writing of their decision to renew or not renew the ongoing advice fee, this can be administered flexibly and by using a range of mediums and technologies. For example, the client can notify the fee recipient in a number of recordable forms, including by facsimile, email, SMS, or through an online facility (including, for example, through a client’s account login on a product provider’s website).*

The draft legislation only refers to confirmation in writing. The inconsistency between the explanatory memorandum and wording of the draft legislation is a matter to be addressed in order to ensure clarity going forward.

Charging Ongoing Fees to Clients (Opt-In)

Consumer Outcomes

It should be noted that research indicates client response rates are low to mail of this nature, even when the matter is in the best interest of clients. There will be many circumstances where a client is unable to respond or is late to respond. A couple of obvious examples are where the client is on extended holiday or in cases where they are unwell or hospitalised. In both these cases it will be difficult for the clients to respond in a short timeframe, however they are likely to want to continue receiving the services.

A termination of the service arrangement in these circumstances is likely to be anything but in the best interests of the client. Where unintended outcomes of this nature are not in the best interests of either the client or the adviser would suggest that this part of the legislation is not going to meet the stated objective.

Administrative Complexity

When you take into account that an adviser will have some clients that are considered pre-commencement and others that are impacted by Opt-In, all with different disclosure dates, all of which are likely to change from one year to the next and clients responding by multiple mechanisms, it is highly likely that there will be significant administrative complexity for advisers and an increased risk of unintentional administrative errors. In the context of the high level of penalties, this will pose a sizable distraction for the adviser that in no way achieves a better outcome for clients.

The AFA further notes that advisers will need to maintain increasingly comprehensive files with regard to the grandfathering arrangements and disclosure dates in order to comply with the draft legislation. Further guidance is required with respect to record keeping obligations for advisers.

Ongoing Liability of the Adviser

The AFA again further questions the relationship between the adviser and client should the client not Opt-In, and further, the degree to which an adviser is required to act in order to ensure that the client has had an opportunity to Opt-In. In this regard, the AFA notes that the Opt-In provision is not simply an Opt-In for a client to continue to pay adviser fees, but is an Opt-In from the client to continue to receive the financial services offered by the adviser. In terms of the expectation of ongoing services, a client who has inadvertently failed to Opt-In may still hold the view that they expect the adviser to provide services. If something after this point goes wrong that gives rise to a complaint, this would still result in the need for the adviser to defend themselves. In this context this piece of legislation might result in advisers devoting significant effort to seeking formal confirmation from clients who have not opted in, that they understand that they will no longer be receiving any services. This is a further complication that works to the detriment of the adviser.

Enhancements to ASIC's Licensing and Banning Powers

The AFA notes that no definition has been provided of "likely to contravene" or "likely to breach" and believes that more guidance is required from the Government or ASIC in this regard, in order to ensure that industry participants fully understand the implications.

Conclusion

Best Interests

The AFA are broadly comfortable with the intent of the Best Interests legislation, however believe that there is a need for greater clarity on a number of the elements as have been set out in this paper.

Opt-In

With respect to Opt-In the AFA strongly disagrees with this proposal and in terms of the draft legislation is extremely disappointed that what has been proposed is significantly more complex than was possible or expected. In this paper we have sought to point out how much of a negative impact this legislation will have on clients and their advisers. These changes will result in a high level of complexity and uncertainty. From an advisers perspective, the current proposal will result in a significant increase in red tape that will cause significant additional administrative effort and cost.

ASIC Powers

The AFA are broadly comfortable with the intent of the Additional ASIC Powers legislation, however believe that there is a need for greater clarity on some of the key new terms with respect to the application of these new powers.

Implementation Dates

In conclusion, with respect to the extent of the change, the level of uncertainty and the tight timeframe, we strongly recommend that the implementation date for FoFA is deferred until a point at least 12 months from the date at which the legislation is passed, to ensure that all parties have the necessary time to implement all the required changes involved in this complex legislation.