



# AIST submission

**Response to: Exposure Draft - Corporations  
Amendment (Future of Financial Advice) Bill  
2011**

**September 2011**



Australian Institute of Superannuation Trustees

## Background

On 26 April 2010, the then Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, announced the Future of Financial Advice (FOFA) reforms. The FOFA reforms represent the Government's response to the 2009 Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services (PJC Inquiry), which considered a variety of issues associated with corporate collapses, including Storm Financial and Opes Prime.

The Corporations Amendment (Future of Financial Advice) Bill 2011 (the Bill) implements the FOFA reforms. The Bill is being released in two tranches, the first of which sets up a framework with the following features:

- A best interests obligation for financial advisers requiring them to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients (best interests obligation);
- A requirement for providers of financial advice to obtain client agreement to ongoing advice fees and enhanced disclosure of fees and services associated with ongoing fees (charging ongoing fees to clients);
- Enhancement of the ability of the Australian Securities and Investments Commission (ASIC) to supervise the financial services industry through changes to its licensing and banning powers.

The reforms focus on the framework for the provision of financial advice. The underlying objective of the reforms is to improve the quality of financial advice while building trust and confidence in the financial planning industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest.

The reforms also include a ban on conflicted remuneration, including commissions, volume payments and soft-dollar benefits. These measures will be exposed for public consultation in the second tranche.

## AIST

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's \$450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

AIST is a registered training organisation and has recently expanded its education program to encompass the growing and changing needs of all members of the not-for-profit superannuation sector.

AIST offers a range of services including compliance and consulting services, events - both national and international - as well as member support. AIST also advocates on behalf of its members to relevant stakeholders.

AIST has recently undergone a vast overhaul, elevating its status as a professional institute to further benefit our members. AIST has introduced a new department – Trustee Governance and Professional Standards – responsible for implementing industry policies and developing a comprehensive framework for the not-for-profit sector.

AIST's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

## Contact

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## 1 Executive Summary

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AIST strongly supports the intent of the reforms to be implemented by the Exposure Draft (“the ED”). With respect to the three features proposed in the first tranche, we make the following recommendations:

### **Best interest obligations**

- Section 961C as proposed in the ED should be principles based and the steps in subsection (2) moved to section 961H and further simplified. Specific details should be expanded in the explanatory memorandum (“the EM”).
- Under the ‘reasonable investigation’ definition, further items of consideration, such as risk, should be included in s 961E for each product examined, however, we believe that defining ‘reasonable investigation’ within the act bears the risk of being overly prescriptive and do not support its inclusion.
- Consideration should be given to remove s 961G and amend s 961J as both subsections cause confusion and ought to be covered by a principles-based approach to s 961C.

### **Charging ongoing fees to clients**

- Fee disclosure statement should be provided to all ongoing clients, regardless of commencement.
- Renewal notice should be provided to all clients who are part of a “book” that has been sold to another provider.
- Definition for existing client is too broad and should, at a minimum, be narrowed to those clients provided with personal advice.
- ASIC to provide guidance on the requirements of the fee disclosure statement and renewal notice.

### **Enhancements to ASIC’s licensing and banning powers**

- Additional to proposed reforms, increase ASIC’s auditing capabilities in line with the concerns raised in the recent ASIC Report 251.

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## 2 Preliminary

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AIST supports the intent behind these measures. We broadly welcome the context of where these obligations are to apply, as well as the situations to which these measures apply. We also consider strongly that these measures constitute much needed consumer protection.

### 2.1 Note to this submission

Unless otherwise indicated, please note that all section and subsection numbers referred to throughout this submission refer to those used to number the proposed new or amended sections of the *Corporations Act 2001* (“the Act”) and not those of the ED.

### 2.2 Limitation to personal advice

We note that in previous communications, the term ‘advice’ had been used in preference to the term ‘personal advice’ and welcome the clarification provided in the proposed subsection 961(1). We recommend that the term ‘personal advice’ in this subsection be bolded to indicate that it has a specific meaning (as that defined in subsection 766B(3)) further recommend extending this meaning to part 7.7A in full, not just division 2.

### 2.3 Limitation to retail clients

AIST has long supported the provision of consumer-friendly measures such as these to all investors, not just retail clients. Whilst we are aware that the focus of the broader reforms is on providing a higher standard of consumer protection to retail clients, we are aware of no concrete reasons why arbitrary reasons such as larger sums of money should be a barrier to proper consumer protection.

### 2.4 Provision of advice via ‘computer program’

AIST welcomes the inclusion of subsection 961(6) that takes into account the use of an application that could feasibly provide an investor with personal advice. Whilst we continue to maintain that a computer program, whether provided over the internet or otherwise, could never provide the same quality of service as a natural person, we support the aims of services provided by licensees whereby scaled advice might be provided by such a facility.

### 2.5 Focus on individual providing advice

We support the focus of this ED on the individual providing the advice, as well as than the licensee or authorised representative. We are aware of the limitations that this has had on the industry in the past and agree that this will facilitate the aim of applying penalties to individuals where necessary.

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## 3 Best interest obligations

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AIST is supportive of the introduction of best interest obligations as part of the reforms. The obligation for individuals who provide personal advice to act in the best interests of their clients is both welcome and necessary and we believe that it will make a significant step towards greater professionalism within the financial services industry.

### 3.1 Section 961C: Provider must act in the best interest of the client

Although we agree and support the intent of section 961C, we find that the legislation is overly complex and would submit that it is not easily understandable to the audience to which it is aimed. We would contend that if the aim is for licensees and advisers to act in the best interests of the client, the obligations need to be explicit, but also take a principled approach.

The danger of providing the steps listed in subsection (2) is that it will be taken by industry as a checklist and will be used as a template to provide advice. This has been how industry has reacted in the past, for instance with the limited uptake and range of topics of intra-fund advice through ASIC Regulatory Guide RG200. We would propose that the steps be moved to section 961H and also that the steps be significantly simplified. Greater detail can be provided in the EM.

In addition, it appears that subsection (2) is an attempt to incorporate some of the 'reasonable basis' provisions presently contained within section 945A within the 'best interest' provisions. We do not agree that this is a good fit. More explanation of this is contained below.

Furthermore, there is description contained in the EM that is not explicitly clear in the ED. In particular we draw your attention to paragraphs 1.25 and 1.29 of the EM that clearly describe scaled advice and its application. However, the relevant passage in the ED, subsection (2)(c), only implies the usage of scaled advice at best. We know that the increase in advice delivery to clients is a major goal of the reforms and we believe that the legislation should highlight the fact that advisers should take note of the most appropriate type of advice that will deliver the right outcome for the client.

### 3.2 Section 961E: What is a reasonable investigation?

AIST recommends that subsection (2) includes items such as risk, complexity and expected performance (including the effect of tax) into what a provider should consider. It should also be noted that the client's interests must be prioritised in these investigations.

We are, however, also concerned that by there may be unintended consequences to defining the term 'reasonable investigation' as prescriptively as what is contained in this ED. For this reason, we do not support the inclusion of this section in the ED.

### 3.3 Section 961G: Approved product lists

AIST recommends the deletion of this section from the ED. We believe that approved product lists are an internal matter for licensees and that the proposed requirements should be already met by an appropriately-worded section 961C.

### **3.4 Section 961H: Resulting advice must be appropriate to client**

As stated above, it is the view of AIST that the ‘reasonable basis for advice’ provisions that are presently contained at section 945A of the Act are a better fit within this section. The reasons that we consider this to be the case is because we believe that the ‘best interest’ provisions to be contained within a principles-based section 961C refer to a hierarchical list of measures that ought to satisfy the best interest requirements, however the ‘reasonable basis’ provisions represent a standard of care. We believe that these sit side by side of each other and cannot be combined.

### **3.5 Section 961J: Resulting advice still based on incomplete or inaccurate information**

Similar to section 961G, we are unsure as to inclusion of this subsection as we believe that this ought to be covered in a principles-based section 961C. Further, if a provider felt that they had incomplete or inaccurate information then they should decline to give advice until sufficient information has been gathered.

We would also like to point out that there are different opinions that exist as to when items of information are considered to be incomplete and/or inaccurate and propose that a measure of materiality be included somewhere in this division.

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## 4 Charging ongoing fees to clients

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AIST is supportive of the proposed reforms regarding ongoing fees for financial advice; however we have a few areas of concern in the draft legislation that we wish to raise. We also note that our understanding of the intent of this policy is to prevent clients being charged for ongoing advice that they do not receive.

### 4.1 Section 962: Application of this division

Under subsection (3), this division only applies where

*(a) the client has not been provided with financial product advice as a retail client by the financial services licensee or the authorised representative before the commencing day; and*

*(b) the client enters into the ongoing fee arrangement on or after the commencing day.*

Where (under subsection (4)) the commencing day is the day on which this part commences.

This means that licensees will only need to comply with the legislation for “new” clients. Essentially, this allows for all current clients who are paying commissions to financial advisers and receiving no advice, to remain doing so. Further, even if they re-engage with their adviser there is no requirement for the licensee to provide a renewal notice as they will still not be considered as “new” clients. This does not seem a dramatic change from the status quo and not a great leap forward for the industry.

Ideally we would like to see these provisions set for all clients. However, understanding that commissions form a substantial part of current financial planning business’ revenue and cash flow, we would propose that if the legislation is to only be effective for “new” clients, then a transition period should be set (say five years) where commissions can continue. After this period, all clients would be covered under the legislative requirements, regardless of when they became a client.

Another issue we wish to raise is the definition of financial product advice under subsection (3)(a). AIST recommends that the definition of ‘advice’ be tightened to refer to personal advice across all of the proposed new part 7.7A for consistency. We strongly encourage that consistency be maintained here to ensure that obligations are not circumvented by the provision of financial product advice that is not personal in nature.

### 4.2 Section 962A: Ongoing fee arrangement, ongoing fee and fee recipient

Under subsection (1)(a), AIST suggests that the word ‘commission’ be added to ensure that these types of payments (e.g. trail commissions and entry fee commissions on superannuation guarantee amounts) are captured:

*(a) a person to whom a financial services licensee, or a representative of a financial services licensee, provides financial product advice as a retail client, agrees to pay a fee/commission (however described or structured)*



#### **4.3 Section 962C: Client not liable to pay fee if this Division not complied with**

AIST would like to see section 962C(1) extended so that if a fee recipient on-sells their client-base then the purchaser must contact all clients purchased with a renewal notice. It is often these clients (usually classed as C or D class clients) which form the passive income of fee recipients. Clients are routinely unaware of who their new adviser is in this situation.

#### **4.4 Section 962E: Fee disclosure statements**

AIST believes that fee disclosure statements and renewal notices should be de-coupled and at the very least the fee disclosure statement should be provided to every client who is being charged an ongoing fee or commission.

Further we would support ASIC-provided guidance on what the fee disclosure statement should look like and how the charges should be expressed as it is well established that a significant number of Australians are innumerate or are unable to understand percentage-based calculations. ASIC could also provide standard performance projection figures based on risk profile for the anticipated fees as many clients do not understand that fees are most often based on the quantum invested and increase as the quantum increases through contributions or investment performance. The statement should also include information on how the client can cease the payments and that it is their right to do so. Naturally, the statement should include the risks in doing so and the fact that doing so will mean the adviser is not obliged to provide advice.

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## 5 Enhancements to ASIC’s licensing and banning powers

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Overall, AIST is supportive of the enhanced licensing and banning powers that are proposed to be given to ASIC. ASIC has raised concerns about its ability to protect investors and we feel that the changes slated to improve the supervision of the financial services industry are critical to creating greater trust within the Australian community toward the sector and moving the financial planning industry further toward a profession.

Further, we support ASIC increasing its auditing capabilities of AFS licensees on the premise that these audits are based on improvement of the quality and appropriateness of advice to individuals. In the recently released *ASIC Report 251: Review of financial advice industry practice* which obtained information from the top 20 licensees, an area of concern was around advice audits (paragraph 21):

*“All participating licensees conducted some advice audits to examine the appropriateness of advice. One area of concern emerged where licensees did not select files for reviews at random (including within a risk-driven approach). We also saw evidence of some licensees notifying their advisers of the files to be reviewed prior to the audit taking place.”*

With the promotion of scaled advice to improve access to advice, we believe that it is vital that ASIC works with industry to improve the take up of scaled advice, but also has the power to protect investors should an advisor or licensee abuse their privileges to provide this advice.