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**FINANCIAL SECTOR REFORM (HAYNE ROYAL COMMISSION RESPONSE –  
PROTECTING CONSUMERS (2020 MEASURES)) BILL 2020: FSRC REC 2.2  
(DISCLOSURE OF LACK OF INDEPENDENCE)**

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**EXPOSURE DRAFT EXPLANATORY MATERIALS**



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# **Glossary**

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
ASIC	Australian Securities and Investments Commission
Bill	Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures)) Bill 2020
Corporations Act	<i>Corporations Act 2001</i>
FSRC	The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry



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# **Chapter 1**

## ***Disclosure of lack of independence***

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### **Outline of chapter**

- 1.1 Schedule # amends the Corporations Act to require a providing entity (a financial services licensee or authorised representative) to give a written disclosure of lack of independence (in a form prescribed by ASIC) where they are authorised to provide personal advice to a retail client.
- 1.2 All legislative references in this Chapter are to the Corporations Act unless otherwise stated.

### **Context of amendments**

#### **Existing law**

1.3 Entities providing financial services are subject to a range of regulatory requirements to protect clients. These obligations include restrictions on the use of terms that indicate that the entity is independent (if this is not the case) and to provide disclosure documents.

#### ***Lack of independence***

1.4 Under subsection 923A(1), the assumption and use of certain words or expressions (including ‘independent’, ‘impartial’ and ‘unbiased’) by or on behalf of entities providing financial services or carrying on a financial services business is restricted.

1.5 Under subsection 923A(2), a person may only use a restricted word or expression in relation to a financial services business or financial service if, broadly:

- the person (or anyone providing a financial service on their behalf or anyone on whose behalf they are providing a financial service) does **not** receive:
  - a commission (other than a commission that is rebated in full);
  - remuneration calculated based on the volume of business placed by the person with the issuer of the product; or
  - other gifts or benefits from the product issuers that may reasonably be expected to influence the person; and

- the person is **not** directly or indirectly restricted in relation to the financial products in respect of which they provide financial services (disregarding certain regulatory restrictions – under subsection 923A(3)); and
- the person does **not** have a conflict of interest arising from a connection with an issuer of financial products that could reasonably be expected to influence the person in carrying on the business or providing the service.

1.6 Otherwise, if a person uses a restricted term in relation to a financial services business or financial services under subsection 923A(1), the person is guilty of an offence. The offence is subject to a fine of up to 10 penalty units for an individual or 100 penalty units for a corporation for each day or part of a day in which the offence was committed (see Schedule 3 of the Corporations Act).

### ***Disclosure***

1.7 Part 7.7 of the Corporation Act (together with the related regulations) imposes a range of disclosure obligations on entities that provide financial services. These obligations include the requirement to provide a Financial Services Guide.

1.8 In summary, a financial services licensee or authorised representative (a providing entity) is generally required to provide a Financial Services Guide to a retail client before providing financial services to that client (see sections 941A, 941B and 941D).

1.9 The main requirements for what a Financial Services Guide must contain are set out in sections 942B and 942C. Among other things a Financial Services Guide must identify who the entity acts for in providing the relevant financial services and provide information about the remuneration received by the entity and certain related entities as a result of the provision of the services. A Financial Services Guide must provide the level of information on the specified matters necessary for a reasonable person to make an informed decision about acquiring the financial services and must be presented clearly and concisely.

1.10 There are a range of other requirements for Financial Services Guides and other disclosure documents set out in Part 7.7 of the Corporations Act and the related regulations.

1.11 A providing entity that fails to provide a satisfactory Financial Services Guide is subject to a civil penalty (see section 1317E). Under section 1317G, the maximum amount of the penalty for an individual is the greater of 5,000 penalty units and 3 times the benefit derived (or detriment avoided) from the failure to disclose. The maximum amount of penalty for a body corporate is the greatest of:



- 50,000 penalty units;
- 3 times the benefit derived of detriment avoided; and
- 10 per cent of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision (up to an amount of no more than 2.5 million penalty units).

## **Financial Services Royal Commission**

1.12 In the Final Report of the Financial Services Royal Commission, Commissioner Hayne considered whether there were additional means by which conflicts of interest could be better managed.

1.13 One such means was to improve the disclosure of conflicts of interest. The Commissioner noted that currently there is no requirement for financial advisers who are not independent to explain to a client that he or she is not independent.

1.14 The Commissioner noted that while a client may be able to infer that a financial adviser was not independent from some of the matters disclosed in a Financial Services Guide, this is not sufficient, and that this matter should be brought to the client's attention in a prominent, clear and concise manner.

1.15 Commissioner Hayne recommended that the law should be amended to require that a financial adviser who would contravene section 923A of the Corporations Act by assuming or using any of the restricted words or expressions identified in section 923A(5) (including 'independent', 'impartial' and 'unbiased') must, before providing personal advice to a retail client, give to the client a written statement (in or to the effect of a form to be prescribed) explaining simply and concisely why the adviser is not independent, impartial and unbiased.

## **Summary of new law**

1.16 Schedule # amends the Corporations Act to require a providing entity to give a written disclosure of lack of independence in the form prescribed by ASIC where they are authorised to provide personal advice to a retail client.

## **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
<p>Providing entities who would contravene section 923A of the Corporations Act by assuming or using any of the restricted words of expressions identified in section 923A(5) (including ‘independent’, ‘impartial’ and ‘unbiased’) must give to a retail client a written statement in the form prescribed by ASIC disclosing their of lack of independence before providing personal advice to the client.</p> <p>The statement is included in the list of statements and information that must be included in the Financial Services Guide.</p>	<p>No equivalent.</p>

## **Detailed explanation of new law**

### **Disclosure of lack of independence by providing entities**

1.17 Schedule # amends the Corporations Act to require a providing entity to give a written disclosure of lack of independence where they are authorised to provide personal advice to a retail client.

1.18 Schedule # also amends the Corporations Act to allow ASIC to prescribe, by legislative instrument, the form of the disclosure statement.

1.19 This new obligation is added to the existing Financial Services Guide disclosure obligations under Division 2 of Part 7.7 of the Corporations Act. The lack of independence statement is included in the list of statements and information to be included in a Financial Services Guide.

1.20 Specifically, Schedule # amends the main requirements for a Financial Services Guide in sections 941B and 941C. As a result of these amendments a providing entity who provides personal advice to a retail client and who would contravene subsection 923A(1) by assuming or using a restricted word or expression (within the meaning of subsection 923A(5)) must include a statement in the Financial Services Guide that:

- sets out that the providing entity is not independent, impartial or unbiased (which are restricted words or expressions within the meaning of subsection 923A(5)), and explains the reasons why; and
- if any other word or expression has been specified as a restricted word or expression for the purposes of section subparagraph 923A(5)(a)(ii)—sets out that the providing entity is not able to assume or use the restricted words or expressions, and explains the reasons why.

*[Schedule #, items 5 and 6, paragraphs 942B(2)(fa) and 942C(2)(ga) of the Corporations Act]*

1.21 For the avoidance of doubt, these amendments do not alter the operation of section 923A either generally or when determining if a providing entity must include a statement as a result of the amendments.

1.22 This ensures, consistent with FSRC Recommendation 2.2, that retail clients receive a disclosure statement about independence that explains clearly and concisely why the providing entity is not independent.

1.23 The same penalty for failing to provide a satisfactory Financial Services Guide could arise where a providing entity fails to comply with the requirement to provide a lack of independence statement.

1.24 The disclosure statement must be consistent with any requirements about the form of the disclosure prescribed by ASIC by legislative instrument (if a legislative instrument has been made). This enables ASIC to ensure, consistent with the intention of Commissioner Hayne, that a providing entity's lack of independence is explained prominently, clearly and concisely to clients. It also ensures that there will be a consistent approach taken to disclosure statements from all providing entities in Australia who must comply with the new obligation. *[Schedule #, item 5 and 7, subparagraphs 942B(2)(fa)(iii) and 942C(2)(ga)(iii) of the Corporations Act]*

1.25 Where ASIC has not made a legislative instrument prescribing requirements for the form of the disclosure statement, a providing entity must still provide the disclosure statement. In such circumstances, providing entities have discretion on the form of the statement but the statement must still satisfy the other two requirements set out in paragraph 1.20.

1.26 Under the current law, a providing entity is generally required to provide a Financial Services Guide to a retail client before providing a financial service to that client. Where a financial adviser is giving advice as an employee of a providing entity, the lack of independence disclosure must still relate to the providing entity, not the employee.

## **Consequential amendments**

1.27 Schedule # to the Bill makes amendments as a consequence of amending the obligations to provide Financial Services Guides by linking the obligation to the restriction in subsection 923A(1). This includes inserting a Note and a provision for avoidance of doubt in section 923A. *[Schedule #, items 1 and 2, section 923A of the Corporations Act]*

1.28 The avoidance of doubt provision clarifies that the use of a restricted word or expression in the lack of independence disclosure statement does not contravene section 923A. This makes clear that a providing entity will not be penalised for complying with the disclosure requirements and stating that they are not independent, unbiased or impartial. *[Schedule #, item 2, subsection 923A(6) of the Corporations Act]*

1.29 Schedule # of the Bill also changes the information that must be provided in circumstances where a providing entity does not provide a Financial Services Guide. The specific amendments are:

- an amendment to include the disclosure of lack of independence in the list of required information that must be provided where financial product advice is given about certain basic deposits and other products; *[Schedule #, item 3, subsection 941C(7) of the Corporations Act]*; and
- an amendment to include the disclosure of lack of independence in the list of required information that must be provided in time critical cases for providing the Financial Services Guide. *[Schedule #, item 4, paragraph 941D(3)(a) of the Corporations Act]*

## **Application and transitional provisions**

1.30 The amendments requiring providing entities to provide a lack of independence disclosure statement apply in relation to personal advice provided on or after 1 July 2020. *[Schedule #, item 9, section 1673 of the Corporations Act]*

1.31 To clarify, Financial Services Guides provided to new clients on or after 1 July 2020 must include the lack of independence disclosure statement.

1.32 A transitional rule applies providing that the disclosure of lack of independence must be provided if the providing entity has given a Financial Services Guide to the client before 1 July 2020 and the financial services are provided to the client on or after 1 July 2020. The statement must be provided whether or not the failure to disclose would be

materially adverse from the point of view of a reasonable person.  
*[Schedule #, item 9, sections 1673 and 1673A of the Corporations Act]*

1.33 This avoids any ambiguity about whether the statement must be provided for services that have been provided with an existing Financial Services Guides.

1.34 To clarify, the providing entity does not need to release a new Financial Service Guide that contains the disclosure of lack of independence from 1 July 2020. In line with existing obligations about updating Financial Services Guides the providing entity may choose to provide it in a Supplementary Financial Services Guide. *[Schedule #, item 9, subparagraphs 1673A(1)(d) and 1673A(1)(e) of the Corporations Act]*