Submission

Exposure Draft

Corporations Amendment (Future of Financial advice) Bill 2011

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Introduction

This submission addresses the release of the Exposure Draft: Corporations Amendment (Future of Financial Advice) Bill 2011. I recommend that the proposed reforms go forward as they provide a necessary protection to consumers that has been lacking under the current law.

If any of the responses require further explanation please contact Dr Marina Nehme at the University of Western Sydney, School of Law at M.Nehme@uws.edu.au.

General Observations

The exposure draft, Corporations Amendment (Future of Financial Advice) Bill 2011, aims to improve the quality of financial advice and enhance consumers‟ confidence in the financial planning industry.

The observations made in this submission can be summarised in the following manner:

- Support the introduction of best interests obligations;
- Support the introduction of the provisions regarding disclosure fees;
- Support the introduction of „opt in‟ clause;
- Support the change of the licensing threshold; and
- Support the change regarding banning orders- such a change is essential to enable the Australian Securities and Investments Commission (ASIC) to monitor compliance of regulated entities with the provisions in the *Corporations Act 2001* (Cth).

Chapter 1- Best Interests Obligations

- **Provision: s 961C**

The exposure draft proposes to introduce s 961C to the *Corporations Act 2001* (Cth). This provision will require financial advisers to act in the best interest of the clients when giving advice. The imposition of such a duty is very important as it reinforces the importance of financial advisers providing services for the best interest of their clients.

Providing adequate financial advice is essential as such an obligation does not only enhance confidence in the financial planning industry but it also has an impact on consumers‟ well-being.[1] For example, a recent study has highlighted that the process of good financial planning may be supportive to individuals on a financial level. Further, it may also affect the clients‟ life satisfaction levels.[2]

- **Provision: s 961K- Complimenting s 961C**

Section 961K of the exposure draft aims to deal with situations where a conflict between the advisors‟ interest and the clients‟ interest may arise. This provision is welcomed as a recent

[1] Kym Irving, Gerry Gallery, Natalie Gallery and Cameron Newton, „I Can‟t Get Satisfaction... Or Can I? A Study of Satisfaction with Financial Planning and Client Well-Being‟ (2011) *Finsia Journal of Applied Finance* 36.

[2] Ibid, 43.

report issued by ASIC on financial advice industry practices illustrated that management of conflicts of interest remains a critical risk within the industry. The report noted that certain products were mainly targeted by the financial advisers to the exclusion of others when providing advice to clients as these products provided the advisors with better profits than other products.[3] In such a situation, there may have been a conflict of interest that led advisers to recommend the more profitable product (to them) over the product more suited to the clients‟ needs. With the introduction of ss 961C and s 961K, such conduct may now lead to a breach of duty and action may be taken against the adviser.

- **Going too far?**

The apparent danger that may arise from the introduction of s 961C is that the proposed duty may be too broad and may impose unreasonable expectation on financial advisers.

It is important to remember that stringent regulation is designed to cope with "bad apples" and unusually hard cases, which in reality constitute a minority of all the problems in the domain of regulatory supervision. Most firms, being "good apples", may accordingly be subjected to unreasonable regulation. In the case of the financial planning industry, the majority of financial advisers are "good apples". For instance, a recent survey regarding the practices of the financial planners has highlighted that the overall satisfaction of clients with the strategies and products provided by financial advisers was 77%. Only 7% of the surveyed clients were dissatisfied with the services provided by their financial advisers and 16% were neutral. Accordingly, the majority of providers are doing a good job. Only a handful of financial advisers are perceived as not providing clients with satisfaction. If s 961C imposes too harsh a regulation, the provision will appear even more unreasonable to the industry because it may raise the costs of business, leading to lost opportunities for the progress of that business.[4]

However, a study of the provisions in the legislation regarding s 961C highlights that the duty to act for the best interest of clients is well-balanced and not unreasonable. For example, „the reasonable investigation‟ that financial advisers have to conduct before prescribing a product does not extend to every financial product available on the market. Such a limitation is welcomed as being reasonable. It is impossible and unreasonable for one person to be aware of every product available on the market.

Further, if a financial adviser is working from an Australian financial services licensee‟s approved product list, they only need to look at that product list. One limitation applies in such instances. If there is no product on the product list that would meet the clients‟ needs, then the provider must inform the client that they cannot recommend a product from the list.[5] Such an expectation is reasonable. As a result, the duty does not impose any unreasonable or rigid regulation on financial advisers. It only really imposes conduct that financial advisers should be already doing.

Lastly, such an obligation does not impose higher standards on financial services licensees when dealing with their financial advisers. The proposed amendments just reflect the obligations that licensees already have under the current s 912A of the *Corporations Act 2001* (Cth).

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[3] ASIC, Report 251: Review of Financial Advice Industry Practice (September 2011), 11, 23.

[4] Eugene Bardach and Robert A Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Temple University Press, 1982), 92-93.

[5] See proposed s 961G.

Chapter 2- Charging Ongoing Fees to Clients

- **Disclosure Obligation**

I support the introduction of fee disclosure statements in order to allow financial advisers to charge ongoing fees for a period longer than 12 months. Such a disclosure statement will not impose an onerous obligation on financial advisers. It will, however, ensure that clients receive updates by their financial advisers on the fees. Such disclosure may improve the confidence of consumers in the financial planning industry. In short, this obligation enhances the transparency of dealings between advisers and their clients. It also should limit abuses in the system.[6]

- **Renewal notice obligation**

The introduction of a renewal notice obligation may be costly to businesses as it relies on clients to take an active role in deciding whether they should agree to renew the ongoing fee arrangement with their current adviser. However, the obligation is not unreasonable as it applies for ongoing fee arrangements that remain in place for more than 24 months. Consequently, it provides clients with an opportunity to assess whether their financial adviser is providing adequate advice. It may also improve the quality of advice and relationship between the financial adviser and the client as the financial adviser will not take the client for granted and vice versa.

Chapter 3- Enhancements to ASIC's Licensing and Banning Powers

ASIC monitors the compliance of regulatory entities with the provisions in the *Corporations Act 2001* (Cth). Consequently, this regulatory agency needs to be equipped with the necessary tools to ensure the compliance of these regulated entities with the law.

- **The change to the licensing threshold**

I support the proposed amendment of s 913B as it provides ASIC with more discretion when issuing an Australian financial services licence. Further, the proposed alteration of s 913B may enhance confidence in the financial services industry as people who may be likely to contravene s 912A- as well as people who will contravene s 912A- will not be eligible to be granted for an Australian financial services licence by ASIC.

- **The change of the banning threshold**

The proposed new tests under which ASIC may issue a banning order may be controversial. On one hand, it is crucial to equip ASIC with the necessary tools to allow the regulator to protect consumers by removing certain people from the industry. On the other hand, it is important to remember that a banning order, as an administrative sanction, cannot have a punitive effect. Such a sanction can only be used to protect the public.[7]

[6] A recent study on the satisfaction of clients with financial advisers highlited that 17% of the clients surveyed did not receive any update from their financial advisers on yearly basis. The introduction of the proposed disclosure obligation will remedy such situations: Kym Irving, Gerry Gallery, Natalie Gallery and Cameron Newton, „I Can"t Get Satisfaction... Or Can I? A Study of Satisfaction with Financial Planning and Client Well-Being" (2011) *Finsia Journal of Applied Finance* 39.

[7] *Re Donald and ASIC* [2001] AATA 622, [55].

In the past ASIC has banned a number of people from working in the financial services industry. This shown in Table 1.

Years	Banning order under s 920A
2009-2010	22
2008-2009	42
2007-2008	49
2006-2007	35
2005-2006	27
2004-2005	25

Table 1- Banning orders under s 920A[8]

While the Table 1 illustrates that 200 banning orders have been issued by ASIC over the last six years, a number of these banning orders have been challenged. One reason behind the challenge relates to the content of s 920A: „ASIC has reason to believe that the person will not comply with their obligation under s 912A‟. The Administrative Appeal Tribunal has noted that „the distinction between what a person will do and what that person may do is very important. A state of mind in which a person has a reason to believe that another person may do something may well be reached before and on less convincing material than is required for a state of mind that the person will do.‟[9]

As a consequence, ASIC has not been able to ban certain people because it could not prove that they „will not‟ comply with their obligations under financial services law. This can be problematic because certain people will be allowed to work in the financial services industry even though they have no understanding of the law. This happened for example in the case of Shaun Bruce Bond. This financial planner did not have an understanding of what is required of him but ASIC was not able to ban him as the regulator could not prove that Bond „will‟ breach the financial services laws.[10] For this reason, it is important to make amendments to the law to allow ASIC to ban people if the regulator believes that there is a risk of non-compliance with the law. This will raise the bar for people working in the financial services industry and it will increase the confidence of the public in the industry.

Conclusion

The Exposure Draft, Corporations Amendment (Future of Financial Advice) Bill 2011, is an important move toward enhancing the standards of the financial planning industry. The proposed reforms are long overdue and may ensure that the financial planning industry is better regulated without adding burdensome or unreasonable rules on the industry.

Dr Marina Nehme

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[8] These figures are taken from ASIC‟s Annual Reports.
[9] *Bond and ASIC* [2009] AATA 50, [45].
[10] *Bond and ASIC* [2009] AATA 50.