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The General Manager
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The Treasury
Langton Crescent
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BY EMAIL futureofadvice@treasury.gov.au

Dear Sir

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

This letter contains some observations and comments on the Exposure Draft of the Corporations Amendment (Future of Financial Advice) Bill 2011 released on 29 August 2011 (**Draft Legislation**).

The main components of the Draft Legislation are:

- the duty of providers to act in the best interests of a client;
- the "opt-in" reforms; and
- increased enforcement powers for ASIC.

The competing policy justifications underlying the Draft Legislation have received much attention in the press, and it is not our intention to reiterate or examine them in this letter. Instead, our focus is on the problems that may arise when interpreting the current Draft Legislation, regardless of the policy rationale behind the new law. The issues are largely restricted to the provisions dealing with the duty to act in the best interests of a client.

Duty to act in best interests of a client

Much of the Draft Legislation pertaining to the duty is confusing and capable of differing interpretations. Without clarity, the reforms will be ineffectual. Even if the clarity results in more onerous obligations, there will be greater benefit, not only for the client but also the adviser through a better opportunity to understand and so to comply with, the obligations. Less time and money should be spent both, in and out, of the already overburdened Courts.

Descriptive and operational provisions combined in same sections

The confusion in the current draft stems from an apparent attempt to have provisions define concepts and simultaneously serve as operative regulation. See, for example, section 961 which defines a "provider" in the context of setting out the scope of application of the new Division 7.7A, as well as sections 961D and 961E that contain the "definitions", or descriptions, of "reasonably apparent" and "reasonable investigation".

Separation of the definitions from the operative regulation should result in increased clarity in each of them.

The structure of the Division should also be clearer. For instance, the definitions should appear at the beginning of the new Division so that it is apparent that they apply to all of the Division.

Level of detail in Draft Legislation raises more questions

Another possible reason for the best interest provisions being confusing is the vast level of detail in the Draft Legislation in the provisions pertaining to the "best interests" duty. The reason for including this level of detail was undoubtedly to minimise the questions and define the scope of the duty to act in the best interests of a client, but however, it is questionable whether this goal will be achieved. An examination of most of the provisions suggests that the increased detail only results in more questions, not less.

Consider, for example, paragraph 961C(2)(e) which requires a provider to assess whether he or she "has the expertise required to give the client advice on the subject matter requested and, if not, declining to give advice". While it is not entirely clear, this seemingly rules out a provider giving any advice to a client. Given that other parts of the Draft Legislation appear to contemplate there being different "subject matters", should the provider, in this case, be permitted to give the client advice on the subject matter on which the provider does have the expertise?

Section 961E also attempts to provide assistance on the question of "what is a reasonable investigation". This section provides the following:

> "(1) A reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client does not require an investigation into every financial product available.
>
> (2) However, if the client requests the provider to consider a specified financial product, or financial products of a specified class, a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client includes an investigation into that financial product, or financial products of that class".

This section raises various questions, including: Whether the investigation required under the second paragraph where the client specifies a class of products extends to all products in the class, or just a reasonable sampling.

Section 961C(2)(f) provides that a provider must assess "whether the client's objectives could be achieved, and needs met, through means other than the acquisition of financial products", but then doesn't specify what the provider must do (in contrast to paragraph (e) immediately preceding (f) which does specify what the provider must do given a particular outcome of an assessment made by the provider).

The possibility for additional questions being raised about the best interests duty is exacerbated by the list of "steps" containing a "step" to base "all judgements in advising the client on the objectives, financial situation and needs of the client". While it is not entirely clear what this means, if this were to remain in the Draft Legislation, it may be preferable that it not be included as a "step", but rather as a separate provision; presumably, it is a requirement that must be applied by considering the client's objectives, financial situation and needs when fulfilling the other steps and anything else that a provider must do when giving a client advice.

Section 961G provides more detail on the duty to act in the best interests of a client where the relevant licensee or authorised representative has a list of approved products. Pursuant to this section, where there is an approved list of products, the provider need not look further than that approved list. Subsection 961G(4) provides that, where the provider is to make no recommendation from the approved list, then:

> "to satisfy the duty under section 961C to act in the best interests of the client, the provider:
>
> (a) must advise the client in writing that the provider cannot recommend a product from the list that might achieve the objectives and meet the needs of the client; and
> (b) must not advise the client to acquire a product that is on the list."

This raises the question as to whether the provider need do anything further, or indeed, whether the provider *may* do anything further in order to satisfy the duty to act in the best interests of a client in these circumstances. One interpretation of the Draft Legislation is that a provider need only look at products on the approved list, and after having done so, if the provider concludes that none of the products are appropriate, then the provider must advise the client in writing that the provider cannot recommend a product. The result is that a provider would have presumably taken the steps of, first, identifying the client's objectives, financial situation and needs and, second, identifying the subject matter of the advice that has been requested, only to find that it cannot recommend a product to a client. This result seems to be inconsistent with an ordinary understanding of what is in anyone's best interests, especially the client that has agreed to pay an upfront flat fee.

Subsection 961C(h) could also benefit from further consideration about its possible application. This section provides that:

"if the provider proposes to advise the client to acquire a financial product in substitution for or in addition to another financial product:

(i) assessing the disadvantages (including risk and increased complexity) in acquiring the product; and
(ii) weighing them against the advantages of not acquiring the product; and
(iii) advising the client to acquire the product only if, having weighed those disadvantages against the advantages, it is reasonable to conclude that the client's objective could be better achieved, and the client's needs better met, if the client acquired the product;…"

The current drafting of this section could be interpreted as meaning that the only time that a provider needs to do the things set out in the section is when the provider proposes to advise the client to acquire a product in substitution or in addition to another financial product. Was the intent of this provision to require the provider to carry out these tasks when advising a

client to acquire a financial product in any circumstances, not just when the product is to substitute or be in addition to another one?

Scaled advice

The provisions of the Draft Legislation pertaining to the best interests of a client also mean that the circumstances in which scaled advice may be given are unduly limited, and based on some interpretations, it may be impossible to give scaled advice and comply with the duty to act in the best interests of clients. Given the recognised benefits of scaled advice, the Draft Legislation may benefit from being redrafted so that scaled advice may be given in those circumstances specified in ASIC Consultation Paper 164. In would also be worthwhile to consider whether the definition of "personal advice" should be amended to facilitate the provision of scaled advice.

General drafting

Further thought and consideration should be given to the words used throughout the Draft Legislation. For example, subsection 916(6) provides that a person who "offers" personal advice through a "computer program" is taken to have provided the advice, and is the "provider" for the purposes of this Division. The reference in existing section 766B refers to "electronic means" instead of "computer program". If "computer program" in the Draft Legislation is intended to refer to the same circumstances of communication as "electronic means" in 766B, then it would be preferable to use consistent terms throughout.

Also, presumably it is not the "offer" of personal advice through a computer program which should result in the advice being taken to have been provided by the person. Rather it is the "provision" of the advice through a computer program (or electronic means) that results in the advice being taken to have been provided by the person .

Section 961D that defines "reasonably apparent" may also benefit from some further consideration. Pursuant to this section, something is "reasonable apparent" if it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice…" It is curious to qualify one's "expertise" to being of a "reasonable level". If a person has "expertise" in particular subject matter, then they are generally thought to be an expert in that subject matter, which, by definition, is not of a "reasonable level", but a very high level. If the intent is to impose a standard of reasonableness, then it may be preferable to refer to skill and knowledge rather than "expertise".

Finally, section 962D requires that a fee disclosure statement be sent to a client 30 days before the "disclosure day". However, section 962E requires that the fee disclosure statement specify the fees paid by the client in the 12 months preceding the "disclosure day" which will, be virtue of the obligation to send the statement 30 days before that day, only occur after the statements have been prepared and sent. If these provisions remain in their current form, then presumably the statements will need to make assumptions about the fees that will be paid during the 30 day period between finalising and sending the statements and the "disclosure day".

Please contact Austin Bell on 02 8247 9620 or Andrew Moore on 02 8274 9525 if you wish to discuss this submission.

Yours faithfully

Johnson Winter & Slattery