NATIONAL INSURANCE BROKERS ASSOCIATION (NIBA)

RESPONSE TO THE CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 (CTH)

About NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 500 member firms and over 2000 individual qualified practising insurance brokers (QPIBS) throughout Australia.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 500 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on risk insurance products.

Executive Summary

Best interest obligations

NIBA opposes the extension of the proposed best interest requirements in sections 961C-961L to the risk insurance industry because:

- the Federal Government has not conducted a risk insurance market review to determine the nature and extent, if any, of issues or concerns in the area of financial advice relating to risk insurance products

- the Federal Government has not undertaken any cost benefit analysis of the impact of applying the suggested reforms to the risk insurance market

- the Federal Government and the Australian Investments and Securities Commission (ASIC) have identified issues and concerns in relation to the provision of financial advice in connection with investments and financial planning. Risk insurance, and general insurance in particular, is a very different type of product, where the nature of the advice is very different to that provided in the investment context, and there is a different set of rights and obligations. Investment advice deals with assets and potential rates of return on the investment of those assets. Risk insurance deals with the assessment and management of risk and the transfer of risk to other parties in appropriate circumstances. This is a very different transaction to that of investments and investment planning.

- there is no evidence of any problem in the risk insurance market akin to that identified for financial planners. The Parliamentary Joint Committee and the Government have identified issues and concerns with financial planners, and all subsequent commentary and explanation has been in the context of investment planning advice. There are significant differences between the risk insurance market and investment products

- by applying the new statutory obligations to insurance brokers for risk insurance products where the obligations cannot be contracted out of or appropriately qualified (as is currently permitted with the agreement of a broker's client and under the NIBA Code):

  - there will be a significant increase in compliance costs (in particular the increase in cost of professional indemnity insurance);

  - less personal advice will be provided for no real consumer benefit as brokers avoid the above costs and increased risks. This is a clear detriment for consumers who need access to competent professional advice on what can be complex issues. Despite Federal Government attempts to simplify insurance documentation the reality is that an insurance product is by its very nature complex and consumers will not generally be inclined/or well equipped to read/understand them. The services of a professional adviser can go a long way to reducing claims issues;

  - less personal advice can result in an increase in under/non insurance which is of real detriment to the community as well as a reduction in competition in the market and the choices available to consumers that insurance brokers bring to the equation; and

  - any increased costs may be passed to consumers for little added benefit.

NIBA proposes that risk insurance be exempted from the current draft legislation. NIBA strongly urges the Government to continue to monitor or at least properly review the general insurance marketplace within an agreed period of time and if any issues of concern are identified, appropriate insurance specific reforms can then be developed and implemented.

This would allow time for the impact of a statutory "best interests" duty to be better analysed in the context of general insurance advice, and would reduce the cost impact of the current proposal on the insurance market and avoid any reduction of the provision of personal advice services.

If despite the above NIBA recommendations, the Federal Government still intends to unfairly and inappropriately apply the proposed requirements to risk insurance:

- subject to the issues raised by NIBA below in relation to the proposed best interests duty being properly addressed, the exception in section 961C(3) that applies to basic banking products should be applied to risk insurance for the reasons set out in this submission and the obligations in s961K and L removed in relation to risk insurance; or

- if the best interests duty cannot be appropriately amended, the obligations in s961K and L could be drafted as the principal obligation ie the obligation to give priority to the interests of the clients and the proposed best interest duty in s961C could be removed (with the existing requirements in s945A and B and 947B remaining unchanged).

Charging ongoing fees to clients

NIBA notes that this requirement was never intended nor proposed to apply to risk insurance products and that an appropriate carve out should be included to reflect the intent and avoid confusion.

Soft dollar commission ban

NIBA notes that at no point was it consulted by Federal Treasury or the Minister about the proposed extension of this proposed ban to life risk insurance.

Why NIBA opposes the extension of the best interest duty to the risk insurance industry

Even if the significant drafting and practical issues raised below are addressed, NIBA maintains its position that the proposed application of statutory best interest obligations to risk insurance brokers is inappropriate and unfair where:

- **Federal Government has not conducted a risk insurance market review or cost benefit analysis of the risk insurance market**

  The Parliamentary Joint Committee on Corporations and Financial Services (PJC) Inquiry was clearly focussed on a review of non-risk insurance type products and services, in particular, investment products and services. There is no identified market failure, and no identified need to reform the obligations that currently exist in relation to risk insurance brokers.

  Investment advice and planning deals with assets, and the potential rates of return on the investment of those assets. Risk insurance deals with the assessment and management of

risk, and the transfer of risk to other parties in appropriate circumstances. The nature of the transaction, the nature of the products, and applicable law and the nature of the advice that is provided are all very different to the nature of any investment transaction.

The Minister has stated very clearly "this is about building confidence in financial advice and the wealth management industry, such that all Australians who work hard their whole life, pay their taxes, save their money, will have a decent next egg along with their house when they retire" (*Inside Business*, ABC TV, 4 September 2011).

The entire focus of these reforms has been financial planning and wealth management, not risk insurance. It is contrary to good public policy, and good regulatory policy in particular, to apply these proposals to an area of activity that is totally different to the area where concerns have been identified.

The risk insurance industry has not had the opportunity of a review similar to that undertaken in relation to financial planning and wealth management, or to make submissions in relation to perceived issues or concerns to the same extent as the financial advisory industry has during the PJC Inquiry process.

Whilst NIBA notes that the Treasury FOFA process has generally been consultative, the main focus has always been on investment products and superannuation. During these discussions, the scope of the proposed statutory best interests duty has remained unclear until the recent release of draft legislation. Whilst NIBA has been part of the Treasury FOFA consultation process, the fact that the risk insurance industry has not been the subject of the same detailed review as financial planners puts it at a significant disadvantage.

NIBA's view is that the benefits for retail clients advised by insurance brokers are likely to be outweighed by the detriments associated with the imposition of a statutory duty on insurance brokers.

- **there is no evidence of any problem in the risk insurance market akin to that identified for financial planners on which the PJC review was actually focussed and there are significant differences between the risk insurance market and investment products**

  No evidence has been provided by the PJC or Federal Government of any problems with the risk insurance industry that are of a nature that would justify the introduction of a new suite of statutory reforms, and the resulting costs and market impact associated with it.

A recent industry review by ASIC found no such problems and the regime (effectively Chapter 7 of the Corporations Act and general law) is working well for insurance brokers and their retail clients. In particular, this is evidenced by the low level of disputes referred to the Financial Ombudsman Service (FOS) in relation to insurance brokers. Insurance brokers are effectively being tarred by the same brush as financial advisers for no good reason.

The risk insurance (in particular general insurance) and investment and superannuation industries and their products, structure and risks are in reality significantly different. For example, insurance is generally a short term product and is often seen as a grudge purchase given it protects a retail client from future risk that in most cases will not occur rather than potentially earning them money. This distinction has been acknowledged in all comparable regulatory regimes worldwide and has also been recognised in the Federal Government's decision not to extend the financial adviser's ban on conflicted remuneration to risk insurance advisers (save for life insurance mixed with superannuation).

- **By applying the new statutory obligations to insurance brokers for risk insurance products:**
  - **there will be a significant increase in the compliance burden carried within insurance broking offices, resulting in additional costs (in particular the increase in cost of professional indemnity)**
  - **there will be less personal advice being provided for no real consumer benefit**

    Recent disaster events have shown that there is real value in retail customers having ready access to personal advice provided by Australian Financial Services Licensees such as insurance brokers. There is no substitute for the provision of advice from qualified advisers such as insurance brokers, and where an unfortunate event occurs in having an insurance claim proactively managed.

    Despite Federal Government attempts to simplify insurance documentation (which have continued since the introduction of the financial services reform legislation), the reality is that an insurance product is by its very nature can be complex and difficult for many to understand. Many consumers are not inclined/or well equipped to read/understand them.

    The services of a professional adviser can go a long way to ensuring retail customers have good advice and get the coverage they need at a proper price, and in reducing claims issues.

Retail customers have access to this advice without having to pay fees or charges. The insurance broker is only remunerated if the customer decides to proceed and purchase a policy. Most importantly, the insurance broker acts as the representative of the policyholder in these transactions, and is not the representative of the insurance company (unless this is made very clear to the client prior to the transaction proceeding).

It would be extremely unfortunate if these proposals were to operate in a way that reduces access to competent and professional advice for retail customers. NIBA's assessment of the proposals is that this is likely to occur.

- **there is likely to be an increase in under/non insurance which is of real detriment to the community**

- **there is likely to be a reduction in competition in the market and the choices available to consumers that insurance brokers bring to the equation; and**

- **any increased costs may be passed to consumers for little added benefit.**

NIBA believes that because of the above, insurance brokers providing personal advice on risk insurance products should not be caught by the new statutory duty. NIBA has no objection to the issue of financial advice in risk insurance being monitored by the Government or ASIC, and if necessary having a proper review within an agreed period of time. To date, however, there has been no evidence of any need for such a review.

If any issues of concern with the operation of the current retail client protections in relation to risk insurance are identified, proper and appropriate proposals for reform could then be developed in consultation with the industry.

This would also allow time for the impact of the statutory duty to be better analysed would no doubt reduce the cost impact of any new statutory duty on the market and would hopefully avoid any reduction in the provision of personal advice services.

NIBA response on proposed statutory best interests obligations

Executive summary

Based on NIBA's review of the proposed legislation, the following five key obligations separately apply to the provider of personal advice to retail clients, and they cannot be contracted out of:

- act in the "best interests" of retail clients when giving the advice;
- take specified (and mandatory) minimum steps to comply with the above best interests duty;
- only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client, had the provider satisfied the best interests duty;
- place the interests of their retail clients ahead of their own when providing the advice; and
- provide a warning to the client if the advice is, or may be, based on incomplete or inaccurate information relating to the client's relevant personal circumstances.

The obligations as proposed are not realistically able to be complied with, would cause significant confusion and argument and would cause most insurance brokers to cease providing personal advice.

This is because the:

- the "best interests" obligation is not properly qualified by reference to the subject matter of the advice and the client instructions, thus not allowing for appropriately measured and agreed advice that has regard to these matters (for example, is it in the "best interest" of the client to have full insurance coverage and a very low insurance excess, or is it in their best interest to have a higher excess and a lower premium? Inevitably, this is a decision the client will make, with the assistance of their professional adviser); and

- the legislation does not contain any defence based on the reasonable conduct of the adviser. This is likely to cause advisers to avoid giving personal advice.

If despite the above NIBA position, the Federal Government still intends to unfairly and inappropriately apply the proposed requirements to risk insurance:

- subject to the issues raised by NIBA below in relation to the proposed best interests duty being properly addressed, the exception in section 961C(3) that applies to basic banking products should be applied to risk insurance for the reasons set out in this submission and

the obligations in proposed sections 961K and 961L should be removed in relation to risk insurance; or

- if the best interests duty cannot be appropriately amended, the proposed obligations in sections 961K and 961L could be drafted as the principal obligation (ie the obligation to give priority to the interests of the clients), and the proposed best interest duty in s961C could be removed (with the existing requirements in s945A and B and 947B remaining unchanged). ASIC could release additional guidance relevant to the above to deal with the matters covered by proposed sub-section 961C(2) and to guide risk insurance advisors about how the obligation to give priority can be satisfied.

Timing issues

The new obligations apply in relation to personal advice provided to a person as a retail client on or after 1 July 2012 (whether or not the request for advice was made before the commencing day).

Based on the current proposals this would in effect require an adviser to conduct a review of all steps taken prior to the legislation applying and the advice being given to ensure they meet the legislation. The practical effect is that this can create duplication of process and a reduction in the transition period, as advisers would have to set up procedures to take account of this reality prior to the legislation start date.

Provider of personal advice obligations

The key obligations have been placed directly on the individual who is giving the personal advice (the “provider”), rather than at the level of the licensee or the authorised representative (AR), as is the case with many of the existing provisions in the Corporations Act 2001 (Cth).

The rules for identifying who the provider is are as follows:

- It will be the individual who provides the advice, even if done on behalf of a licensee or AR - NIBA has no concerns with this.

- If there is more than one provider of the advice, each is treated as the provider – NIBA is concerned that there is no mechanism to deal with the situation of one adviser taking over from another adviser part way through the transaction (e.g. one goes on holidays or is sick). It appears that to avoid the risk of breach and banning order by reason of direct failure or involvement in the contravention by another adviser by reason of the conduct of the prior

adviser, the new adviser would need to go through the process from the start. A form of reasonable reliance defence for the second adviser should be considered. If not, this could significantly slow down transactions and increase the costs of compliance and advice. Alternatively, the provision would act as yet another disincentive to the provision of personal advice to retail customers.

- If it is not reasonably possible to identify the individual(s), the person who provides the advice is the provider - NIBA notes that it is not entirely clear who this would be but assumes the end result would be the relevant licensee or AR which currently in the context of the existing legislation are referred to as the "providing entities".

- The person who offers personal advice through a computer program will be the provider – NIBA does not believe it is clear who the provider would be and suggests that it be the person(s) who represent to the retail client that they are providing the personal advice via the program. This would force advisers to clearly identify who provides the advice via such programs. NIBA understands that the intent of the above is to only catch personal advice provided directly to a retail client by a computer program rather than advice offered by one which then could be provided otherwise or provided by an adviser after use by the adviser of the program. It may also be worthwhile clarifying what is meant as being included by the concept of a computer program to ensure it at least covers the current market practices.

- If a licensee acts as AR of another licensee, the obligations apply to the first licensee as if it is an AR and not as a licensee in its own right. This is aimed at clarifying the situation where the licensee is acting under a binder in accordance with section 916E of the existing Corporations Act (section 961) – NIBA has no concerns with this.

Obligation 1: Best interests duty (sub-section 961C(1))

This is a broad new general obligation requiring the provider to "act in the best interests of the client when giving the advice".

The concept is not defined. According to the Explanatory Memorandum (EM), the principle guiding the application of the best interests obligation is that "meeting the objectives, financial situation and needs of the client must be the paramount consideration when providing advice".

Based on discussions with Federal Treasury and the papers that have been issued as part of the consultation process, the aim is not for the obligation to require that the adviser provide the "best advice" nor convey a trustee duty. A trustee can for example only act in the interests of its beneficiaries.

NIBA notes that this requirement is a stand-alone obligation. While there are minimum steps required in section 961C(2), as set out in Obligation 2 below, relevant to meeting this duty, none of these limit the extent of the best interests duty itself.

NIBA notes that the EM in paragraph 1.34 provides that "There is nothing in the best interest obligation that necessarily prohibits a provider from receiving remuneration other than from the client (for example, a commission from an insurance provider). However, a provider in receipt of this remuneration must ensure they are complying with the steps above and are giving paramount consideration to the objectives, financial situation and needs of the client."

In relation to the separate requirement in section 961K the EM states "1.49 The obligation to give priority to the interests of the client does not mean that the provider can never pursue their own interests or the interests of another party (for example, the licensee). However, the provider will breach this obligation if, in pursuing their own interests or the interests of another party, the provider fails to give priority to the interests of the client if there is a conflict."

This does not however appear to be relevant to the best interests duty.

There is also no reference in the section to the ability in the provision to scale or taper the advice having regard to the subject matter of the advice. For example, reasonable investigation of financial products should not go beyond the scope of the agreed subject matter of the limited advice.

This issue needs to be treated very carefully when it comes to general insurance risk products, particularly retail insurance products. As noted above, a policyholder often has options in relation to the size of the insurance excess that will form part of the policy. The ultimate decision will be taken by the client after considering a wide range of issues, including the costs and benefits of a higher or lower excess.

Similarly, many insurance policies include optional coverage, invariably involving additional premium obligations. The insurance broker will help and advise the client in reviewing these options, but it is not at all clear how the statutory "best interest" test applies to the resolution of these matters. In one sense, it is always in the client's best interest to have the best possible insurance cover for a particular risk, but invariably that comes at the highest price. It is important that the client has access to sound and competent advice in resolving these matters, without the adviser having to be concerned to try to work out whether the advice and assistance being given complies with the statutory tests in sub-section 961C(2).

Whilst ss961C(2) comes close (but in NIBA's view fails as noted below) it only sets out minimum standards that do not affect how broadly the best interests duty could be interpreted.

Accordingly, NIBA's concern is that there is no clear statement one way or another in the legislation (only the limited statement in paragraph 1.34 of the EM) that clearly sets out the required qualification/intent to make the duty workable.

The end result is that the basic articulation as drafted could be argued to be seen as analogous to the best interests duty of a trustee or require the best advice. This is likely to give rise to unnecessary argument (and the costs associated with such arguments). Professional indemnity insurers of advisers will inevitably take such matters into account in pricing their risk.

NIBA believes that the statutory "best interests" concept by its very nature causes more issues than it solves when not qualified.

The other key problem is the fact that the proposed legislation does not contain any defence. Without some form of protection centred on the reasonable conduct of the adviser, there is a substantial risk that advisers will choose not to provide personal advice. This would be a very unfortunate outcome for retail clients generally.

Obligation 2: Take minimum steps in acting in the best interests of the client (sub-section 961C(2))

Under the proposed legislation providers must also, as a separate obligation, take certain minimum steps in acting in the best interests of the client.

However, NIBA notes that these are not exhaustive and are not intended to operate as a checklist for compliance with the best interests obligation.

The EM explains: "This is because it is not possible in advance for the legislation to address the broad range of financial advice relationships and situations." It goes on to note: "However, they operate to provide an indication of what, as a minimum, is expected of financial advisers in order to be considered to have acted in the best interests of the client. In addition, they should guide advisers as to the nature of action required under the best interests obligation."

As noted above the best interest duty is not qualified by reference to the subject matter of the advice.

The steps that the provider must take in acting in the best interests of the client include, but are not limited to, the following (these are essentially processes the adviser must have in place prior to the advice being provided in compliance with the best interests duty):

(a) identifying the objectives, financial situation and needs of the client that are disclosed to the provider by the client through instructions

This is, in effect, the client needs analysis based on their instructions. NIBA has no issues with this requirement.

(b) identifying the subject matter of the advice that has been requested by the client

NIBA is concerned that “subject matter” is not defined and it is open to argument as to what it means. For example, is it the particular product/product class/type requested (for example, a comprehensive motor insurance policy), or what the client wants advice on (e.g., assets to be protected – I don’t want my motor car stolen), or a mixture of both (ie vehicle security and anti theft devices, or an insurance product)? Section 961C(3) suggests that it can be the particular product/product type/class, as it states that “the subject matter of the advice requested by the client is solely a basic banking product”. Clarification of this draft provision is required.

There is also no qualification that what must be identified need only be what is reasonable in the circumstances. If this is not done, the obligation is extremely onerous and practically unworkable.

As noted above, the best interests duty has not be qualified having regard to the subject matter of the advice which in NIBA’s view is crucial.

(c) **where it is reasonably apparent that information relating to the objectives, financial situation and needs of the client that is given by the client in instructions is:**

(i) incomplete for the purposes of providing the advice on the subject matter requested; or

(ii) inaccurate;

make reasonable inquiries to obtain complete and accurate information

Something is “reasonably apparent” if it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice that has been requested by the client, were that person exercising care and objectively assessing the information given to the provider by the client (section 961D).

The EM notes that this requirement is included because the provider cannot solely rely on the instructions from the client. The information only needs to be complete in relation to the subject matter of the advice, and this means that it is not necessary for providers to obtain every piece of information possible about the client, but only information that is necessary for the subject matter of the advice. This means that the test is of a higher standard when the subject matter of the advice is highly complex and technical in nature.

NIBA notes that the obligation is not limited to making enquiries of the client and could in certain cases be seen as putting an onus on the provider to go behind the client to third parties in order to verify information, etc. For example, if the insurance broker suspects that the client's outline of their driving history and offences may be inaccurate, does this provision require the broker to pursue a driver licence check with the relevant licensing authority prior to arranging insurance? This can create a number of complexities for the provider and should be limited accordingly.

(d) where it is reasonably apparent that the client's objectives could be better achieved, or the client's needs better met, if the client obtained advice on another subject matter, either in addition to or in substitution for the advice requested, advising the client in writing of that fact

The EM explains that this requirement is designed to:

… accommodate the provision of limited advice (also referred to as "scaled advice") that only looks at a specific issue (for example, single issue advice on retirement planning) and "holistic" advice that looks at all the financial circumstances of the client. In situations where limited advice has been requested by the client the adviser is able to tailor the information they obtain about the client solely to what is necessary to provide that form of advice. However, the adviser is required to exercise professional judgement and advise the client if they believe advice on another subject matter could better meet the client's needs and objectives. This reflects the fact that retail clients may not always know what type of advice will meet their needs and objectives.

NIBA notes that it will be difficult for an adviser to form a view on whether they meet this test or not. The concepts of "better achieved" or "better met" would impose a high onus on the adviser.

The "reasonably apparent" test is based on whether it would be apparent to a person with a reasonable level of expertise in the "subject matter of the advice", as opposed to "another subject matter". The "another subject matter" to be considered is also not limited to financial products (in a risk insurance scenario, this could arguably involve advice on whether self-insurance or other non-insurance arrangements are appropriate).

The EM notes that a provider will need to raise this earlier if it affects the substance of the advice given to the client. This requirement is in reality likely to result in a standard form notice being provided in every case in the insurance context to manage risk.

The obligation to notify the client in writing is also a significant new obligation and cost on insurance brokers that are not (for good reasons) required to provide written Statements of Advice (eg, most general insurance).

NIBA does not believe this obligation is appropriate for insurance brokers advising on risk insurance products given the nature of the transaction, the nature of the advice that is provided, and the practical and cost issues that arise in the risk insurance context.

(e) assessing whether the provider has the expertise required to give the client advice on the subject matter requested and, if not, declining to give advice

NIBA raises the same concern noted above regarding the definition of "subject matter". NIBA notes that in (b) the reference is to the "subject matter of the advice that has been requested by the client" not the "subject matter requested" as noted in this provision.

(f) assessing whether the client's objectives could be achieved, and needs met, through means other than the acquisition of financial products

The EM states: "This step will be most relevant in situations when the adviser is formulating broad, strategic advice. In cases where the needs and objectives of the client relate to a specific aspect of a financial product, only a limited assessment is required."

NIBA notes that the provision is not drafted so as to qualify the obligation in the way the EM indicates it is intended to operate.

There is also no "reasonable in the circumstances" qualification. It is not appropriate for a risk insurance type scenario e.g in a situation where car insurance is requested. Applied ot this scenario, the requirement puts an onus on the advisor to make further enquiries (e.g better risk mitigation strategies such as increased security etc) even if not reasonable to do so given the client is clearly only seeking insurance for their car. The additional cost of incorporating such a process is clearly inappropriate in a risk insurance retail products context.

(g) either:

(i) conducting a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client of which the provider is aware and assessing the information gathered in the investigation; or

(ii) if another individual has made such an investigation and the provider has access to the results of the investigation — assessing the information gathered in the investigation [If a provider doesn't have access to the results, they don't appear to be able to meet this requirement]

NIBA notes that the objectives and actual needs of the client can be different.

What is a "reasonable investigation" is defined differently depending on whether there is an approved product list or not.

Where there is no approved product list, a reasonable investigation does not require an investigation into every financial product available. 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 (section 961E).

The EM notes that this test "does not require an investigation into every product that is available on the market given that in many cases this would be impractical and costly".

NIBA notes that the breadth of the above provision could impose an obligation on the adviser to investigate *all products of the relevant class* if asked, and they cannot contract out of this or qualify the service to be provided.

The concept of "awareness" is not defined but will be very important in such cases.

This requirement is a classic example of a draft statutory provision, which has been developed for one type of financial advice, being totally in appropriate and unrealistic when applied to another area of financial advice, namely the risk insurance context. This provision will again act as a major disincentive to the provision of personal advice to retail customers in relation to general insurance.

Where:

- the provider is a licensee or a representative of one or an AR of one, or an employee of an AR of one; and
- the licensee or AR (as relevant) maintains a list of financial products that it recommends, or authorises its representatives/employees to recommend; and
- it is reasonably apparent that there is no product on that list that would achieve the objectives and meet the needs of the client,

the reasonable investigation test does not require the provider to investigate products that are not on the list.

However, to satisfy the duty under s 961C to act in the best interests of the client, the provider:

- must advise the client in writing that the provider cannot recommend a product from the list that might [NIBA notes that the concept above is "would", so this appears to be inconsistent] achieve the objectives and meet the needs of the client; [NIBA queries what if it meets most of needs but not all, e.g., 95%, of needs, as product is not "perfect" - what happens then?]; and
- must not advise the client to acquire a product that is on the list (section 961G).

NIBA notes that the effect of the above is to shut down the risk insurance personal advice market where product lists exist as if a product only meets 95% of a client's needs the insurance broker cannot recommend it. No product will 100% meet the client's needs as risk insurance products only provide cover the insurer is prepared to provide and will never meet the client's needs (by way of example, no motor vehicle insurance policy would provide cover in the event that the driver has exceeded the blood alcohol limit).

The concept of "needs" does not work in this context and is not appropriate. The reasonable basis for advice requirements in s945A only require that the advice be appropriate to the client having regard to the consideration and investigation of the relevant personal circumstances in relation to giving the advice. It does not require that the product meet the needs as this will in most cases not be possible.

The effect appears to be to impose a best product advice model and if you can't advise on best product you can't advise. This is fine if you charge a fee for service as you still get paid. This will not be the case for risk insurance brokers that are remunerated by commission.

(h) 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 objectives could be better achieved, and the client's needs better met, if the client acquired the product.

NIBA notes that s947D does not use the term "substitution" and refers to "replacement" and "disposal" or "reduction in an interest" in an existing product. The intent of section 947D was not to apply to renewal of an insurance policy and NIBA assumes that despite the

different terms, the intent is the same. If not this would be inappropriate and cause significant problems.

In general, this requirement is not subject to the scope of the subject matter of the advice or the client's instructions. In the risk insurance context this will result in insurance brokers not being able to provide personal advice on risk insurance products if the client does not want them to consider the existing product and understands the risks of this limited/scaled advice service. To proceed would breach the duty. This in NIBA's view should be allowed. It also forces clients to obtain full advice even if not needed.

(i) basing all judgements in advising the client on the objectives, financial situation and needs of the client.

NIBA does not see this provision as adding much given the requirement in 961H.

Obligation 3: Appropriate advice obligation (section 961H)

The Bill repeals existing section 945A of the Corporations Act and introduces a new appropriate advice provision that also takes into account the best interests obligations.

A provider must only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client, had the provider satisfied the duty under section 961C to act in the best interests of the client.

NIBA notes that this obligation is not specifically qualified by reference to the subject matter of the advice as is the case with current section 945A and creates significant problems for insurance brokers. As the proposed statutory best interests duty currently imposes in effect a best advice type requirement and this requirement is considered in that context, it becomes unworkable for insurance brokers.

Obligation 4: Give priority to the interests of the client where there is a conflict of interest

The next obligation (which is independent of all of the above) is that the provider must give priority to the interests of the client in situations where there is a conflict between the interests of the client and the interests of the provider.

This is more akin to a fiduciary duty, except it obliges priority to be given and cannot be contracted out of.

In addition, if the provider knows, or reasonably ought to know, that there is a conflict between the interests of the client and the interests of:

- a licensee of whom the provider is a representative; or
- an AR of whom the provider is an employee,

the provider must give priority to the client's interests when giving the advice (section 961K).

The EM explains these provisions as reinforcing the best interests obligations where the objectives, financial situation and needs of the client must be given paramount consideration by the provider. The EM relevantly states:

"The obligation to give priority to the interests of the client does not mean that the provider can never pursue their own interests or the interests of another party (for example, the licensee). However, the provider will breach this obligation if, in pursuing their own interests or the interests of another party, the provider fails to give priority to the interests of the client if there is a conflict … Consistent with the best interest obligations, a provider does not breach the obligation to give priority merely by accepting remuneration from a source other the client (for example, a commission paid by an insurance provider). However, if the provider gives priority to maximising a non-client source of remuneration over the interests of the client, the provider will be held in breach of their obligations."

No guidance is provided on the concept of "reasonably ought to know" which will be of great significance. Further, it is not clear that an advisor can give "priority" to the client's interests if the interests of the advisor and the interests of the advisor are aligned in relation to particular advice.

In NIBA's view it is unnecessary duplication to have both the best interests duty and this obligation.

As noted above, the proposed legislation does not contain any defence based on the reasonable conduct of the adviser. Without this, there is a substantial risk that advisers will choose not to provide personal advice.

Obligation 5: Incomplete or inaccurate advice warning

This replaces existing section 945B and provides that if it is reasonably apparent that information relating to the objectives, financial situation and needs of the client on which the advice is based is incomplete or inaccurate:

(a) the provider must warn the client that:

  (i) the advice is, or may be, based on incomplete or inaccurate information relating to the client's relevant personal circumstances; and

(ii) because of that, the client should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs; and

(b) the warning must be given to the client at the same time as the advice is provided and by the same means as the advice is provided, or in a Statement of Advice if this is the means by which the advice is provided or if the Statement of Advice is given to the client at the same time as the advice is provided - note: the Statement of Advice must at least contain a record of the warning (see paras 947B(2)(f) and 947C(2)(g)) (section 961J).

If two or more individuals provide the advice and one of those individuals provides a warning in accordance with this section, the other individuals are taken to have complied. Nothing in this section affects the duty of the provider under section 961C to make reasonable inquiries to obtain complete and accurate information (see para 961C(2)(c)).

NIBA notes that the "reasonably apparent" requirement is a new test and currently it is a knowledge or recklessness based test. Such changes require new procedures and associated costs of training etc.

General law obligations not replaced (section 961B)

The new proposed requirements will not replace any existing general law duties which can continue to apply (ie fiduciary duty and duty of care, etc). As noted by NIBA these are already significant and currently working well in the risk insurance adviser context.

Licensee obligations

NIBA makes no specific comments in relation to these obligations.

Charging ongoing fees to clients

NIBA notes that this requirement was never intended nor proposed to apply to risk insurance products and that an appropriate carve out should be included to reflect the intent.

The definition of an ongoing fee arrangement in section 962A is extremely broad. All that is needed is an agreement to pay a fee and that the fee not be relating to advice that at the time the arrangement is entered into has not been given. General insurance brokers may get the client's agreement up front to charge a fee before providing the relevant advice for the general insurance

policy and on provision of the advice the fee is charged on arrangement of the policy. It is not an "ongoing" fee of the type intended to be caught and yet it appears to be because the definition does not incorporate the "ongoing" concept. The obligations that are then imposed regarding fee disclosure statements and renewal notices are not appropriate in such a context as it is a one off fee for those services.

Soft dollar commission ban

NIBA notes that at no point was it consulted by Federal Treasury or the Minister about the proposed extension of this proposed ban to life risk insurance.

If you would like to discuss any aspect of this matter further do not hesitate to contact us.

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