Corporations Amendment (Streamlining of Future of Financial Advice) Bill and Regulations 2014

Submission
19 February 2014

Introduction

The Stockbrokers Association of Australia is pleased to provide these comments on the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill* 2014 and the *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation* 2014.

The Bill and Regulation, which were released for comment on 29 January 2014, are generally **welcomed** by the Stockbrokers Association. They make the following reforms to the FOFA provisions of the *Corporations Act 2001*:

- restoring the Accountants' Certificate expiry period to 2 years
- extending the Stamping Fee exemption to investment entities like LICs
- removing the opt-in requirements
- removing the annual fee disclosure requirements for pre-1 July 2013 clients
- removing the 'catch-all' provision from the best interests duty
- explicitly allowing for the provision of scaled advice
- exempting general advice from the ban on conflicted remuneration, and
- broadening the existing grandfathering provisions for the ban on conflicted remuneration.

We would like to make the following comments on certain aspects of the reforms.

Timing

We note that the reforms are to be made by both legislative amendment and regulation. This is to enable time-sensitive amendments to be made in the near future through regulation, and then locked into legislation thereafter. We commend the Government for proposing to enact these reforms in the most timely manner possible.

Industry has made a long transition to FOFA. Certainty is now needed as to the final position. This is essential for licensees, and their clients. Moreover, ASIC is in a difficult position during this period of uncertainty in relation to its approach to enforcement. Ideally, it must either take a formal no-action stance, or enforce the current provisions until they are amended. Whether this is possible in the current uncertainty remains to be seen.

Conflicted Remuneration

Throughout the FOFA process, we submitted that the whole prohibition on *conflicted remuneration* needed to be reconsidered and redrafted so that it was better aligned to the *actual objectives* of FOFA. Rather than prohibiting the movement of funds between financial product issuers or sellers and advisers, there needed to be some **nexus** to the actual definition of *conflicted remuneration* i.e. where a benefit is given to a licensee or their representative in respect of *advice* provided to a client that might influence the financial product recommended or the financial advice given.

Conflicted Remuneration prohibition should apply to Personal, not General advice

One of the primary concerns we always had with the conflicted remuneration provisions was the fact that they originally applied to the provision of **both general and personal advice**. Expanding the scope of FOFA to general advice unnecessarily complicated the implementation and administration of the regime. Including general advice in the FOFA provisions made the scope of the prohibition so broad as to make it unworkable.

In our opinion, the inclusion of general advice went well beyond the original intention behind FOFA i.e. removing the risk of retail clients receiving conflicted advice that may be inappropriate for them due to the fact that the adviser is being paid a commission. By definition, **general advice does not take into account a person's needs or objectives so it is not appropriate to apply a conflicted remuneration regime when a recommendation is not being made based on the person's individual circumstances**.

We are pleased that the scope of FOFA is being narrowed to its original intent. Financial advisers that are paid commissions in respect of the advice that they provide to their clients are generally (if not always) providing personal advice and in our opinion it is this type of advice that was intended to be addressed by FOFA. The fundamental value proposition of any party that provides personal advice (including stockbrokers and financial planners) is that they provide advice that it **tailored** to the needs of their clients. Consistent with the best interests duty – which only ever applied to personal advice – we welcome the narrowing of the ban on conflicted remuneration to the provision of **personal advice.**

We also welcome the clarification of the '**client pays**' exception via a new Note to s963A, which will make it clearer that benefits paid by the client includes benefits *authorised* by the client. Clear and specific client authority should remove the risk of conflicted remuneration ever being paid.

Scaled advice

In traditional stockbroking, clients often seek advice on a limited basis, for example, a brief inquiry as to which stock(s) to buy or sell. Clients don't often require a full financial plan or advice on their entire circumstances or portfolio of investments. We were therefore pleased to see further measures in the proposed reforms to accommodate clients and their limited requirements.

ASIC has previously noted that according to surveys around **one-third** of Australians prefer scaled or 'piece-by-piece' financial advice rather than comprehensive or 'holistic' advice.[1] (Our Members would suggest that if this survey were solely conducted in **stockbroking**, the figure would be significantly **higher** than one-third.) Previously, while scaled advice was mentioned in a *Note* to s961B(2)(g), and acknowledged by ASIC in regulatory guidance, the new provisions will allow greater certainty. The adviser and client will be able to agree to limit the scope of advice that is sought so that the client's needs should be better met.

Accountants' Certificate renewal period restored to 2 years

We welcome the restoration of the 2 year renewal period for Accountants' wholesale client certificates which was reduced to 6 months by FOFA. As we stated in our letter to the Assistant Treasurer of 22 January 2014,

> *There is no policy justification for having a 6 months expiry period for Accountants' certificates in the context of financial Advice and 2 years for share offers. The rationale for the certificates has always been the same: they serve as an independent assessment of the superior financial position of a client that can be relied upon in the assessment of their status as wholesale, so as not requiring all the disclosure and other obligations owed to a retail client. They serve the same function in the context of advice as they do for share offers. There is no justification for two different renewal periods applying to Accountants' certificates in the two contexts.*

OTHER MATTERS

Finally, we wish to raise two other FOFA-related issues which appear to have been overlooked in the current reforms:

- the review of the definitions of 'retail' and 'wholesale' investors, and
- Share Registry Mining.

1. *Review of Retail/Wholesale client definitions*

In January 2011, following one of the recommendations of the PJC *Storm Inquiry Report*[2] the Government released an Options Paper in a wide-ranging review of the definition of

[1] ASIC Regulatory Guide 244 *Giving information, general advice and scaled advice* December 2012 at RG 244.6

[2] Parliamentary Joint Committee on Corporations and Financial Services *Inquiry into financial products and services in Australia - Report* November 2009

retail and wholesale clients under the *Act*[3]. In late February 2011, submissions closed. These definitions are crucial the whole structure of the regulation of financial services and financial advice. It is therefore a matter of some concern that, 3 years after submissions closed on the options paper, no final or interim proposals arising from the 2011 review have been released.

2. *Share Registry Mining*

In 2012, we raised an issue with Government regarding the differential regulation of the permitted uses of share registers[4]. The effect of the current provisions is that licensees that are not market participants can access share registers to solicit business from shareholders. However, market participants are prohibited from doing so. There is no policy or regulatory justification for this ban, and we urgently seek its removal in the current round of reform.

Such an amendment would fit squarely in the spirit of deregulation. It could be achieved by simply deleting the offending paragraph, namely Corporations Regulation 2C.1.03(b). (For full details of this issue, please refer to our Letter of 7 August 2012 **attached.**)

While the above two matters were not included in the current proposals - and time will probably prevent them being included in the current round - we are concerned that they will again lose priority and may be forgotten in the Government's financial services policy formulation.

We are once again grateful for the opportunity to comment on what we trust (apart from the two matters last mentioned above) will be the **final tranche** of substantive FOFA reforms. The reforms should contribute to the original aim of facilitating better and more professional advice to more investors. Importantly, they should also achieve this without compromising investor protection.

Should you require further information, please contact me, or Doug Clark, Policy Executive dclark@stockbrokers.org.au .

David W Horsfield
Managing Director/CEO
STOCKBROKERS ASSOCIATION OF AUSTRALIA
19 February 2014

[3] Australian Government *Wholesale and Retail Clients - Future of Financial Advice Options Paper* dated January 2011

[4] Stockbrokers Association *Letter to the Hon Bill Shorten MP Minister for Financial Services and Superannuation Access to Share Registers* dated 7 August 2012 **(attached)**

Attachment

7 August 2012

The Hon Bill Shorten MP
Minister for Financial Services and Superannuation
Parliament House
Canberra ACT 2600

Dear Minister

Access to and use of Share Registers

- *Corporations Act 2001 Section 173(3A)*
- *Corporations Regulation 2C.1.03*

We would like to raise a serious anomaly in the law. This matter has been the subject of previous discussions with you and your staff and with Treasury officials earlier this year. This letter is provided to formalise our Submission.

The anomaly is that **shadow brokers** (i.e. licensed dealers and/or advisers in securities who are not market participants) have the right to gain **access to share registers** of companies for solicitation of business, but **market participants** (i.e. stockbrokers) are specifically **prohibited** from doing so. The anomaly appears to be an unintended consequence which has no proper policy basis.

Accordingly, we seek to have the anomaly remedied urgently. This could be easily achieved by the **removal of one paragraph** in the *Corporations Regulations*, namely Regulation 2C.1.03(b).

The Law

Section 173 of the *Corporations Act* 2001 sets out the conditions under which a person has the right to inspect and obtain copies of share registers. Under sub-section 173(3A), in order to obtain a copy of the share register, a person must apply to the company as follows:

(3A) An application is in accordance with this subsection if:
(a) the application states each purpose for which the person is accessing the copy; and
(b) **none of those purposes is a prescribed purpose**; and
(c) the application is in the prescribed form. *(emphasis added)*

Paragraph (b) above states that the purpose of access to the share register must not be a ***prescribed purpose***. The meaning of *prescribed purpose* is set out in Regulation 2C.1.03, which states:

Improper purposes for getting copy of register
For paragraph 173 (3A) (b) of the Act, the following purposes are prescribed:
(a) soliciting a donation from a member of a company;
(b) **soliciting a member of a company by a person who is authorised to assume or use the word stockbroker or sharebroker in accordance with section 923B of the Act;**
(c) gathering information about the personal wealth of a member of a company;
(d) making an offer or invitation to which Division 5A of Part 7.9 of the Act applies.
(emphasis added)

Under section 923B, only market participants authorised by ASIC can use the term *stockbroker*. The inclusion of paragraph 2C.1.03(b) above - i.e. prohibiting *soliciting by a stockbroker* - is the **nub of the problem.** We would submit that the appropriate **solution** is to remove that paragraph.

Background to the 2010 Amendments

The above provisions were added to the *Act* by amendments in late 2010[1]. The area of unsolicited offers and access to share registers has long been a concern to our Members and their clients. Whilst the regulation of unsolicited offers was tightened through reforms introduced in 2004[2], there remained areas for improvement in the rules for accessing share registers and making unsolicited offers for securities.

The then Minister for Superannuation and Corporate Law Senator Nick Sherry, at our Annual Conference in May 2009, announced proposed amendments to further address the issue of unsolicited share offers. The Minister released an *Options Paper* at the Conference[3] which included the following proposals:

[1] *Corporations Amendment (No. 1) Act* 2010 (No. 131 of 2010) (the '**2010 Amendments**')
[2] Chapter 7 Division 5A of the *Corporations Act*
[3] Australian Government *Access to share registers and the regulation of unsolicited off-market offers – Options Paper* May 2009 ('*Options Paper*')

- Introduction of a proper purpose test for access to share registers (Option A)
- Cost recovery for companies providing access to share registers (Options B&D), and
- Formatting requirements for provision of share registers (Option C).

The key driver for all the reforms relating to unsolicited share offers was and has always been the potential for shareholders to be unfairly taken advantage of by unscrupulous operators. As stated in the *Options Paper* –

> *The unethical nature of these offers, together with their significant level of profit making, continues to generate concern among shareholders and the broader community*[4].

In Option A to the Paper – the Proper Purpose Test – there was no discussion or proposal which made reference to market participants.[5] At the time, we welcomed the announcement. Indeed, we supported the proposal in our Submission to the proposals outlined in the *Options Paper*[6].

The makers of these unsolicited offers were not market participants (i.e. stockbrokers), but unlicensed and unregulated businesses. In the *Options Paper*, and all the discussion and consideration about regulation of unsolicited offers which led to the reforms in 2004 and 2009, no issue was raised as to the conduct of stockbrokers. This is because stockbrokers were and remain the most highly regulated entities in the financial services sector. As well as holding Australian Financial Services Licences, stockbrokers are also regulated as market participants by ASIC, and until 2010, ASX. As market participants, stockbrokers are subject to higher standards of conduct, capital requirements and investor protection, enforceable by fines of up to $1,000,000 under the ASIC *Market Integrity Rules* (previously the ASX *Market Rules*).

No other AFSL holder is subject to this level of regulation, certainly not the shadow brokers. Indeed, recently the higher management and supervision standards of market participants have been implicitly recognised in the

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[4] *Options Paper* page 17

[5] *Options Paper* pages 3-5

[6] Securities & Derivatives Industry Association (the former name of the Stockbrokers Association of Australia) *Submission: Options Paper on Access to share registers and the regulation of unsolicited off-market offers* 23 July 2009

Stockbrokers Carve-outs to the conflicted remuneration provisions of the FOFA amendments, which only apply to market participants[7].

It is entirely understandable therefore that the reforms to tighten the regulation of unsolicited offers have **never** been aimed at market participants. Accordingly, we do not understand how the 2010 Amendments ended-up including a Proper Purpose Test which discriminated against stockbrokers, especially since such a test had not been previously announced or proposed.

Stockbrokers are the only persons mentioned in the 2010 Amendments as being prohibited from making contact with shareholders via access to share registers. The practical effect of this prohibition has been that, while stockbrokers cannot contact shareholders from the register, **any other person** (including shadow brokers) **can**. Shadow brokers have used this regulatory advantage to their great benefit in soliciting business from shareholders in trading and capital raising.

The prohibition on stockbrokers using share registers was not flagged by Government ahead of the 2010 Amendments. It lacks any basis, and we believe it is a case of unintended consequences. We therefore request that the matter be addressed – by the **removal** of *Regulation* 2C.1.03(b) – as soon as possible.

Thank-you for the opportunity to bring this matter to your attention. We would be happy to discuss this matter further with you at your convenience. Should you require any further information, please contact me or Doug Clark, Policy Executive on dclark@stockbrokers.org.au .

Yours sincerely,

David W Horsfield
Managing Director/CEO

cc. Mr Jim Murphy, Executive Director, Markets Group, The Treasury

[7] Future of Financial Advice: *Corporations Amendment Regulation* 2012 (Third Package – June 2012) Draft Regulation 7.7A.4.12(6)(a) (sharing of brokerage with representatives)