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The Treasury
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By online submission form

Dear Secretariat

HSF submission in response to the Quality of Advice Review Proposals Paper

1 Introduction

This submission is made by Herbert Smith Freehills (**HSF**) in response to the Quality of Advice Review (the **Review**) proposals paper *Quality of Advice Review – Proposals for Reform* (**Proposals Paper**), which was open for consultation on 29 August 2022.

HSF is an international law firm with 25 offices located around the globe and which specialises in, amongst other things, financial services and financial services regulation.

2 Executive summary

In our view, the Proposals Paper outlines a practical roadmap for working towards more accessible and affordable advice for consumers. The focus on the content of advice and the proposals to remove unnecessary documents and processes, such as fee disclosure statements and statements of advice, is very welcome.

Whilst we strongly support the majority of the Proposals outlined in the Proposals Paper, there are some aspects of the Proposals on which we wish to comment. In summary:

1. We do not support the proposed expansion of the definition of 'personal advice' (**Proposal 1**). Whilst we see merit in reducing regulatory uncertainty, we are concerned that general marketing by a product issuer would be seen to be giving 'personal advice' to some clients but not to others. Moreover, the same conduct when carried out by a party that is not a product issuer may not be regulated as financial product advice under Proposal 2.
2. We suggest that the proposal to deregulate 'general advice' (**Proposal 2**) be modified to only apply in respect of 'general advice' that is provided to 'wholesale clients'. We consider that deregulating 'general advice' provided to retail clients could expose vulnerable consumers to harm – for example, we are concerned about the endorsement of financial products by financial influencers ('**finfluencers**').
3. We support in principle the proposal to replace the 'best interests duties' with an obligation to provide 'good advice' (**Proposal 3**). However, we are concerned that the phrase 'reasonably likely to benefit' may be interpreted by industry, regulators or litigants to mean improving the financial position of and akin to achieving superior financial *outcomes* for the client. In our view, 'good advice' might include advice which may not be seen to 'benefit' the client, such as advice to move to a more conservative investment strategy or to take out insurance which is ultimately not called upon. 'Good advice' may also encompass a less quantifiable outcome, such as assisting a client to better manage their financial affairs.
4. We support the proposals in relation to improving the ability for superannuation fund trustees to provide advice to their members, or to pay for advice out of superannuation monies (**Proposals 5, 6 and 7**). However, we see merit in further expanding the ability for Australians to use their super to pay for financial advice that relates to retirement outcomes.

We commend the work of the Reviewer and, subject to the comments outlined in this submission, see significant value in implementing the Proposals outlined in the Proposals Paper.

3 Proposed expansion of the definition of 'personal advice' (Proposal 1)

We do not support the proposed changes to the definition of 'personal advice' as they are currently framed.

Whilst we understand and appreciate the desire to reduce regulatory uncertainty, we consider that the proposed changes to the definition of 'personal advice' will lead to unintended consequences and inequalities in the way advice is regulated.

Specifically, if 'personal advice' is expressed to include any financial product advice that is provided where the provider has, or holds information about a client's objectives, needs or any aspect of the client's financial situation, this will mean that a product issuer that markets its products to the general public will be subject to a different standard of care depending on whether the advice is received by:

- an existing customer of the product issuer (this is likely personal advice because the product issuer is likely to hold information about one or more aspects of the client's financial situation); or
- a consumer that has no relationship with the product issuer.

We acknowledge that, under the Proposals, it would be less onerous for a product issuer to cross the 'personal advice line' (for example, the product issuer would not be expected to provide a Statement of Advice).

However, we are of the view that there is merit in retaining the distinction which currently exists in the law between:

- advice that is given without regard to a person's objectives, financial situation and needs; and
- advice that is given in circumstances where the provider of the advice has either considered, or might objectively be expected to have considered, one or more of the person's objectives, financial situation and needs.

That said, we are not philosophically opposed to the suggestion that one-on-one communications between a product issuer and a client should be regulated as personal advice where a recommendation or opinion is provided to the client about a financial product, provided that this is coupled with implementation of the proposals to remove the requirement to provide a Statement of Advice or Financial Services Guide (Proposals 8 and 9).

Our concern is that the effect of this proposal in practice would be that financial product issuers would need to treat all marketing as 'personal advice' and, therefore, ensure that the product issuer satisfies the proposed 'good advice' duty, whereas the same communication by someone other than a product issuer (such as a 'finfluencer') would not be regulated as financial product advice at all given the proposal to not regulate 'general advice' (Proposal 2).

One alternative would be to exempt general marketing from 'personal advice'. However, to our minds, a better way to achieve this same outcome would be to retain the current definition of personal advice.

4 Proposal to deregulate general advice (Proposal 2)

We propose that general advice continues to be regulated when provided to retail clients and deregulating general advice that is provided to wholesale clients.

In our view, the regulation of general advice provided to wholesale clients is an unnecessary regulatory burden and ultimately delivers little value. For example, where products or funds issued by a special purpose vehicle are marketed by the experienced manager or promoter, which is commonly the case overseas, the manager or promoter needs to hold an Australian financial services licence (**AFSL**) or use an AFSL exemption

to provide wholesale offer documents or marketing information in Australia but the less experienced issuer would be able to use the advice exemption in *Corporations Regulations 2001* (Cth) Reg 7.1.33H. This layer of regulation adds no value when marketing products and services to institutional investors in Australia such as superannuation funds, who in our view do not require (or ultimately wish to bear the cost of) the consumer protections afforded by the regulation of 'general advice'.

However, given the pace of change in the way 'general advice' (as it is currently defined) is provided to consumers, we consider that there is merit in continuing to regulate the provision of general advice to retail clients as a financial service.

We are particularly conscious of ASIC's work in relation to the proliferation of 'finfluencers' – that is, social media influencers who discuss and promote financial products and services. In 2021, the ASIC 'Young People and Money' survey found that 33% of 18-21 year olds follow at least one financial influencer on social media. The survey found a further 64% of young people reported changing at least one of their financial behaviours as a result of following a finfluencer. ASIC recently released Report 735 *Retail investor research* which found that since March 2020, 41% of investors source financial information from social media and networking platforms, 10% of those specifically from finfluencers.

Whilst we acknowledge that other consumer protections exist, including the prohibitions on engaging in misleading or deceptive conduct (including conduct which is misleading by omission) in relation to financial services or products under section 1014H of the *Corporations Act 2001* (Cth) (**Corporations Act**) and section 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**), we consider that these protections do not, of themselves, provide sufficient protection to vulnerable retail clients who may receive general advice through the use of social media in particular.

Where general advice is regulated as a financial service, the person giving the general advice must either hold an AFSL or use an AFSL exemption, for example, being appointed as a representative of an AFSL holder. In our view, there are important conduct obligations that arise under the licensing regime which provide protections to consumers, including the duty to act 'efficiently, honestly and fairly' (We note that the Australian Law Reform Commission has proposed changes to the formulation of that duty and we have separately made submissions in relation to that proposal.)

We agree with the comments in the Proposals Paper regarding the distinction between 'general advice' and 'factual information' and support the views expressed in paragraph 1.7 of the Proposals Paper. However, we remain concerned that there is a need to regulate 'finfluencers' who endorse specific financial products. We are also concerned that there are likely to be further developments in the way social media is used to promote financial products which cannot necessarily be anticipated at this time.

Separately, we support the proposal to remove the requirement to provide a general advice warning, which forms part of Proposal 2. For similar reasons, we see merit in removing the requirement to provide an 'advertising warning' under s1018A of the Corporations Act.

5 Proposal to replace the 'best interests duties' with a 'good advice' duty (Proposal 3)

The best interests duty and its related obligations are contained in Division 2 of Part 7.7A of the Corporations Act. They require advice providers, when providing personal advice to retail clients to:

- act in the best interests of the client (s961B(1) of the Corporations Act);
- give appropriate advice (s961G of the Corporations Act);
- warn the client if advice is based on incomplete or inaccurate information (s961H); and
- prioritise the client's interests (s961L).

(together, the **Best Interests Obligations**).

We support the proposal to repeal the Best Interests Obligations and to formulate an alternative duty which is outcomes-focussed. However, we have reservations about the proposed formulation of words used to define what constitutes 'good advice'.

'Good advice' is defined in the Proposals Paper as advice that would be "reasonably likely to benefit the client, having regard to the information that is available to the provider at the time the advice is provided."

The Proposals Paper indicates that such formulation is "intended to be easily understood" and to "focus attention directly on the consumer and the advice rather than on the provider and the process for formulating the advice." We support these intended outcomes.

However, in our view, the phrase 'reasonably likely to benefit' may be interpreted by industry, regulators or indeed litigants to mean improving the financial position of and akin to achieving the best *outcome* for the client, by way of illustration, it could become seen as producing superior financial outcomes. In any event, in our experience such a formulation could well lead to a cohort, and potentially large one, of financial advisors exiting the industry and thus ironically lessening access to advice.

In our view, 'good advice' might include advice which may not be seen to 'benefit' the client. By way of example, an adviser might reasonably recommend to a client that the client:

- move investments from a high-risk investment strategy with traditionally high long-term returns to a more conservative investment strategy, depending on the client's risk appetite and financial circumstances;
- take out insurance which is paid for but ultimately not called upon; or
- do nothing to change their investment strategy at a particular point in time.

In each of the above circumstance (and, we submit, in many other circumstances), advice which may be seen as objectively 'good' may be regarded with the benefit of hindsight as not meeting the proposed 'good advice' test.

In our view, if the duty was introduced, the phrase 'reasonably likely to benefit' should be replaced by phrases akin to 'reasonably likely to be beneficial to' or 'reasonably likely to assist in managing the affairs of'. To our minds, there is an important distinction to be drawn between advice that is 'reasonably likely to benefit' a consumer and advice that is 'reasonably likely to be beneficial to' a consumer. 'Good advice' may also encompass a less quantifiable outcome, such as assisting a client to better manage their financial affairs.

In the Proposals Paper, it is said that "the greater the risk of harm, the more work a provider will need to do to be satisfied they are in fact providing good advice". We are concerned that this aspect of the Proposal is also likely to be assessed with the benefit of hindsight and may incentivise advisers to seek to 'de-risk' portfolios or to not provide advice. To our minds, this is the danger of an outcomes-focussed test – if not implemented properly, it may influence behaviour in a way that does not benefit consumers.

In any event, in our view it does not necessarily follow that imposing a 'good advice' duty would require the provider of the advice to 'do more work' where there is a greater risk of harm. To our minds, the question of the amount of 'work' an adviser needs to do is a *process* question which is not asked by an outcomes-focussed test.

In our view, there is merit in continuing to regulate process to some extent. However, this is arguably achieved through the general obligations imposed on the holder of an AFS licence under section 912A of the Corporations Act to maintain the competence to provide financial services covered by the licence, to have adequate risk management systems in place and to do all things necessary to ensure that the financial services covered by the licence are provided 'efficiently, honestly and fairly'.

It is important to note also that a provider of personal advice may be subject to a range of additional duties under common law and under statute, depending on the circumstances.

In particular, an adviser who is a fiduciary will owe duties to their client under common law such as the duty of care and fiduciary duties (profit and conflict rules).

One further challenge that we see in this regard is that certain product issuers, such as superannuation trustees, are fiduciaries. If the intent of the proposals is to enable product issuers to act in their own interests where the advice is 'good advice', we submit that this will not be achieved solely by removing the Best Interests Obligations and that further reform will be required.

Separately, we support the proposal to require a 'relevant provider' to comply with professional standards (Proposal 4), although we have reservations about the proposal to continue to permit a digital advice provider to provide advice to a customer for a fee without the provider (or any of its employees) being a 'relevant provider'. To our minds, as digital advice evolves, there may be merit in more closely regulating certain aspects of it.

6 Proposals relating to superannuation (Proposals 5, 6 and 7)

We support the proposals in relation to improving the ability for superannuation fund trustees to provide advice to their members, or to pay for advice out of superannuation monies (**Proposals 5, 6 and 7**). However, we see merit in further expanding the ability for superannuation trustees to provide personal advice and for Australians to use their superannuation to pay for financial advice that relates to retirement outcomes.

In section 3.1 of the Proposals Paper, it is said that it is not obvious that the 'sole purpose test' in section 62 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) authorises the application of superannuation fund monies for providing personal advice to members. We agree with this statement. We further submit that the same could also be said in relation to *general advice;* however, we acknowledge that whether this is relevant turns largely on whether Proposals 1 and 2 are implemented.

Leaving that issue aside, we turn to the question of the scope of personal advice that a superannuation trustee should be permitted to either provide or to apply fund assets to meet the costs of providing.

Paragraph 3.3 of the Proposals Paper suggests that the scope of such advice should be limited to advice about the member's interest in the fund. In our view, there is merit in broadening the scope of this proposed authorisation to allow members to obtain personal advice that *relates to* (but is not necessarily 'about') their interests in the fund.

To our minds, there is an opportunity for superannuation funds to play a broader role in improving retirement outcomes for their members by providing better access to personal advice about matters relating to, but not limited to, their superannuation interest. Further, in our view it is difficult for a trustee to provide 'good advice' without having the ability to holistically consider the financial situation, objectives and needs of the member.

For example, members leading up to retirement would often benefit from having access to affordable and scalable advice about maximising their social security entitlements, which may involve increasing the amount they contribute to super. In our view, it would be reasonable and appropriate for trustees to be able to provide such advice.

Equally, a member may require advice about transition to retirement or retirement income products, and it may be the case that a superannuation trustee providing 'good advice' would recommend a product offered by a different financial services provider (such as a life insurer or an alternative superannuation trustee). In our view, it is not clear whether such advice would fall within the ambit of being 'about' the member's interest in the fund.

As section 3.1 of the Proposals Paper draws out, the retirement income covenants in section 52(8A) of the SIS Act seems to purport to *require* the trustee to 'assist' beneficiaries to achieve a range of stated objectives relating to retirement. We submit that the ability for trustees to provide personal advice should be aligned with a trustee's obligations under section 52(8A) of the SIS Act (and, by corollary, section 52AA).

We agree with the comments in paragraph 3.4 of the Proposals Paper regarding section 99F of the SIS Act and support its repeal. A further concern we have with respect to section 99F is that could be interpreted to mean that a trustee can never pass the cost of

providing *general advice* onto members, which appears an unintended consequence of the shortcomings in the drafting of this section highlighted in the Proposals Paper.

Finally, we wish to comment on the ability for adviser service fees to be deducted from a superannuation account.

We support the comments and proposals in section 4 of the Proposals Paper, subject to one caveat, being that we consider that the obligation on superannuation trustees to ensure that advice fees relate solely to superannuation should be removed.

As the Proposals Paper correctly points out, the legal basis upon which adviser service fees are paid from super balances is currently flawed. In our view, the expectation that superannuation trustees monitor the performance of advice licensees is unreasonable and rooted in the concept that an adviser service fee is an expense of the fund. We propose that advisers be solely responsible for ensuring that the fees they deduct from a superannuation fund relate to the member's interest in that Fund and that superannuation trustees be relieved of the burden of seeking to monitor the activities of advice licensees.

The Proposals Paper refers to the duty of a trustee to ensure insurance premiums do not inappropriately erode retirement outcomes and raises the question of whether paying for advice from superannuation raises the same question. We submit that it does. Whilst we propose that superannuation trustees should not be obliged to monitor the activities of advice licensees, we consider that it would be reasonable for superannuation trustees to be required to have processes in place to ensure that the amount of adviser service fees can be charged from the fund is not inappropriate or unreasonable.

7 Conclusion

Thank you for providing us the opportunity to comment on the Review. If you would like to discuss the matters raised in this submission, please contact one of the FSR partners at the details below.

Yours sincerely

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