Governance Institute of Australia

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General Manager
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The Treasury
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By email: futureofadvice@treasury.gov.au

Dear Treasury

Exposure Draft — Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

Governance Institute of Australia is the only independent professional association with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our Members are all involved in governance, corporate administration, company secretarial practice and compliance with the *Corporations Act 2001* (the Act), within public listed and public unlisted companies, private companies, public sector agencies and not-for-profit organisations, with their primary responsibility being the development and implementation of governance frameworks.

Governance Institute of Australia welcomes the opportunity to comment on the Exposure Draft — *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* (the bill) and draws upon the experience of our Members in providing our response.

General comments

The Future of Financial Advice (FoFA) reforms were introduced to provide better protection for consumers of financial products and services. Governance Institute of Australia notes that the original FoFA reforms arose in response to the 2009 *Inquiry into Financial Products and Services in Australia by the Parliamentary Joint Committee on Corporations and Financial Services* (the PJC Inquiry) which investigated the issues surrounding the corporate collapses of various financial service providers, such as Storm Financial and Opes Prime.

The PJC Inquiry itself noted that its role was to make necessary recommendations for legislative change or regulatory improvement to help guard against the occurrence of corporate collapses in the future and improve the quality of financial advice Australian consumers receive.[1] The PJC Inquiry noted, further, that it had formed the opinion over the course of the inquiry that it had 'sufficient broad and consistent evidence to justify making a series of carefully considered recommendations which are designed to enhance professionalism within the financial advice sector and enhance consumer confidence and protection.[2]'

[1] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, p149
[2] Ibid at p150

The original FoFA reforms attempted to strike this balance by introducing further consumer protections while simultaneously requiring financial advisers to meet higher standards of care and skill.

Governance Institute understands that there has been ongoing commentary about whether or not the right balance has been struck, and that the current round of reforms are aimed at re-distributing the balance with a view to ensuring that financial advisers are not burdened with unnecessary compliance requirements.

We note that the proposed reforms do not contain provisions that cover those who have been provided advice in the superannuation and managed fund context previously. It is possible that advice has been provided to a client on a superannuation product or managed fund product and that trailing commissions have been continued to be paid for many years. Many clients will have forgotten who they dealt with and have likely not heard from their advisers on these products in many years, yet these advisers will continue to receive benefits from the individuals without any further work being required. Governance Institute believes that where ongoing trailing commission arrangements are in place and will be grandfathered under the existing legislation, there should be some requirement that every person whose funds are currently being reduced by ongoing trailing commissions, be reminded of those arrangements.

We note, however, that the bill does make the following key amendments to the FoFA legislation, including:

- removing the opt-in requirement for clients of financial advisers, whereby clients are required to renew their ongoing fee arrangement every two years
- changing the requirement for advisers to provide fee disclosure statements to clients who entered into their arrangement after 1 July 2013
- removing the catch-all provision in paragraph 961B(2)(g) from the list of steps that a financial adviser may take in order to satisfy the best interests obligation
- expressly providing for the facilitation of scaled advice, and
- exempting benefits relating to general advice from the ban on conflicted remuneration.

The accompanying explanatory memorandum also indicates that such changes are time-sensitive and that these changes will be made in regulations before being put formally in legislation at a later stage.

Substantive nature of proposed reforms to FoFA regime should be put forward in legislation and not in regulations

Governance Institute is of the view that the proposed amendments to the FoFA regime are substantive in nature. They cannot be categorised as simply a clarification of matters as they overturn key recommendations of the PJC Inquiry.

Governance Institute is therefore of the view that the amendments contained in the bill should not be dealt with through regulations and then later locked into legislation, as is proposed.

While we recognise that the government is of the view that some of the amendments are time-sensitive, Governance Institute believes that this is insufficient reason to put these changes in regulations which are subject to a lower level of scrutiny in parliament. While regulations may be subject to the passing of a disallowance motion, they are not subject to debate in parliament. By contrast, the process for review of legislation ensures that such matters are appropriately introduced and debated in parliament, thereby providing a higher level of parliamentary scrutiny.

Governance Institute recommends that all of the reforms contained in the bill be put through as legislation rather than regulations.

Potential for uncertainty for financial advisers and consumers

Alongside these proposed reforms to FoFA, the government has also initiated an inquiry into the Australian financial system (the financial system inquiry). Governance Institute notes that the nature of the proposals put forward in the proposed changes to the FoFA legislation and the manner in which they will be carried out seem counter-intuitive to the objectives of the financial system inquiry.

The final terms of reference for the financial system inquiry explicitly include a statement that the inquiry will recommend policy options addressing 'the needs of users with appropriate financial products and services.' Governance Institute believes that implementing the FoFA reforms prior to any deliberations or recommendations from the financial services inquiry on the needs of users with appropriate financial products and services could see the current proposed reforms subject to further amendment within a short space of time, should the financial services inquiry make recommendations to this effect. This will serve only to confuse both financial advisers and consumers.

Governance Institute also notes that the Australian Securities and Investments Commission (ASIC) has already had to publicly advise that in light of the government's proposed changes it will not take enforcement action in relation to the specific FoFA provisions that are likely to be repealed. We believe that this situation creates uncertainty for those seeking to ensure that they have complied with their obligations, and for consumers seeking to understand if their needs have been appropriately considered.

Our comments on the specific measures put forward in the bill are set out below.

Specific comments on the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

Removal of the catch-all provision

Governance Institute recognises that the 'catch-all' provision in s 961B(2) of the Act creates uncertainty and ambiguity in its current form. We note that the current form of the measure seemingly renders the safe harbour unworkable for advisers due to its open nature. Nonetheless, we believe that the 'catch-all' also provides valuable protection for consumers.

In this regard, the proposed amendment effectively repeals the adviser's duty to act in the best-interests of the client. Under the proposed amendment, once an adviser and their client agree upon the scope of the advice it will only have to be 'appropriate', rather than in the client's best interest. We believe that this amendment is contrary to ensuring that there remains an intention that any advice, even that limited by agreement, is provided in the client's best interests.

By effectively repealing the adviser's duty to act in the best interests of the client, the proposed amendment of the 'catch-all' provision in s 961B(2) has the potential to create loopholes that allow financial advisers to once again receive sales commissions, ongoing fees, volume rebates and other incentives to sell a product. Such loopholes would see financial advisers being paid for the provision of conflicted advice that is not necessarily in the best interest of the consumer. It was this mischief that the recommendations of the PJC Inquiry sought to address. The Inquiry report was firmly of the view that a best interest duty was necessary to improve the minimum quality of advice in Australia.

Governance Institute is of the view, therefore, that rather than weakening this essential protection, the provision should clarify that the onus of proof rests with the person alleging the breach of this section so as to ensure that the honest and competent practitioner is not exposed to defending unreasonable actions. That is, a complainant seeking to utilise this section should be able to demonstrate that the financial adviser should reasonably have known about a particular circumstance, and they had disregarded it, or they failed to take reasonable steps to act in the best interests of the client based on the information available at the time.

Governance Institute recommends that the proposed amendment to the 'catch-all' provision in s 961B(2) should not proceed in its current form, that is, the amendment to this provision should not repeal the adviser's duty to act in the best interests of the client but clarify that the onus of proof rests with the person alleging the breach of this section.

Facilitating scaled advice

Governance Institute supports the proposal to allow the financial adviser and client to agree on the scope of the advice to be provided. We believe that it is essential that the customer clearly understands the scope of the advice provided and the statement of scope should include both the subject matter and extent to which the advice is general or tailored to the client's specific circumstances. We note that such an approach will reduce red tape for financial advisers, and reduce uncertainty as to what type of advice is to be provided. This measure will also benefit clients by allowing them to ask for specific and targeted information more relevant to their needs, if they require it.

Removal of the opt-in requirement

The opt-in requirement requires financial advisers who have an ongoing fee arrangement with a retail client to obtain their client's agreement at least every two years to continue the ongoing fee arrangement. It applies to new clients who enter into an ongoing fee arrangement from 1 July 2013.

The financial adviser is required to provide a renewal notice to the client which sets out the ongoing fee arrangement, as well as what will happen if the client elects not to renew the arrangement, or if they do not respond to the renewal notice. This provision provides a strong consumer protection and promotes better transparency and accountability for financial advisers.

While Governance Institute is cognisant that the opt-in provision also creates an administrative burden for financial advisers, we oppose the removal of the opt-in requirement, on the basis that it places the control over the advising relationship in the hands of the financial adviser and provides no capacity for the consumer to assess if the ongoing fee arrangement remains suited to their needs. The elimination of this provision, therefore, removes a valuable consumer protection which was implemented to accord with the recommendations of the PJC Inquiry.

Governance Institute recommends that the opt-in provision not be removed from the legislation.

However, if the government decides to proceed with the removal of the opt-in requirement, Governance Institute recommends that an alternative approach be taken to ensure that a form of consumer protection remains in place. **Governance Institute recommends** that the removal of the opt-in requirement be tempered with an obligation on the financial adviser to continue to include the proposed fee arrangement in a renewal notice, as currently set out, but for the onus to revert to the client to terminate the relationship. That is, the renewal notice should set out the same information as is currently required, but provide that the arrangement continues unless the client explicitly elects not to renew the arrangement, and that if the client does not do anything, the arrangement will also continue. This is an opt-out requirement.

Such an approach, if adopted, eliminates the need for financial advisers to seek to obtain consent to continue to charge fees of the client. However, such an arrangement can only work if the client's attention is clearly drawn to their right to discontinue, and includes a requirement that this right cannot be satisfied in the small print of a substantial document.

Education and training exemption from ban on conflicted remuneration and other banned remuneration

Governance Institute notes that the government has committed to exempting general advice from the ban on conflicted remuneration. We recognise that, under the current law, the education and training exemption provides an exemption from the ban on conflicted remuneration for education and training related to the provision of financial product advice.

While we support the move to broaden the exemption provided in relation to education and training to allow for upskilling, we are also of the belief that a limit should be set on the extent to which the exemption applies. Governance Institute is of the view that the exemption should apply only to ‘reasonable’ training costs rather than being uncapped, as currently exists.

Governance Institute also notes that in its current form there is the potential for the exemption to be abused by advisers seeking to gain further financial advantage but for little educational gain.

Conclusion

Governance Institute recognises that these measures have been introduced to reduce the red-tape and compliance obligations created by the implementation of FoFA reforms. However, we reiterate that weakening key provisions without providing for alternative, adequate consumer protections effectively returns the financial advice regime to the pre-existing regulatory framework.

While we appreciate that the government has committed to implementing further reforms to FoFA, it is important, as we have commented previously on FoFA reforms, that there is a need to ensure that the reforms are appropriately considered before they are implemented. Any proposed amendments should be tightly worded to prevent clients being taken advantage of, or the gaining of hidden remuneration in conflict with the principle that advisers have to act in the best interests of clients. We also believe that it will be important to ensure that there is ongoing monitoring of the industry to quickly detect and stamp out any deviations from the objectives of ensuring the public can rely on the advice being given and that advisers are not unfairly remunerated.

Governance Institute looks forward to seeing the outcomes of the consultation and the revised bill. We would welcome the opportunity to discuss any of our views in greater details.

Yours sincerely

Tim Sheehy

Tim Sheehy
Chief Executive