Stockbrokers
Association of Australia
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ASIC Consultation Paper 182

Future of Financial Advice: Best Interests duty and related obligations – Update to RG175

SUBMISSION

CP182 sets out ASIC's proposed guidance on how to meet the best interests obligation and other obligations in Div 2 of Pt 7.7A of the *Corporations Act*. It includes a proposed redraft of the current Regulatory Guide RG175 *Licensing: Financial product advisers – conduct and disclosure*. RG175 was first released in June 2003 as PS175 in the lead-up to the commencement of Financial Services Reform (FSR).

RG175 is an important statement of ASIC's views on compliance with the advice requirements. It is often cited by the authorities and the Financial Ombudsman Service in any regulatory review or determination of disputes.

The Stockbrokers Association of Australia would like to provide comments on the following aspects of CP182:

1. To whom the best interests obligations apply
2. Record keeping
3. 'Perfect Advice' not required
4. Putting client in better position, and
5. The 'Safe Harbour' in s961B(2)

1. To Whom the best interests obligations apply (p.9 Table 1)

In CP175, ASIC states that the best interests obligation applies to the '*advice provider*'. Section 961 says that the Division applies to '*providers*', which means the individual adviser, unless the advice is provided by an automated system. ASIC should not imply that '*advice provider*' is a term defined in the *Act*. The new Division is different to the old one (s945A etc) in its focus on the individual's responsibility. However, as to civil liability it is not materially different, since

civil liability only attaches to the licensee, not the individual: s961M. The major difference is that the new provisions, unlike the old ones, are not criminal offences. (Of course ASIC can still take regulatory action against individuals, like banning orders.)

2. Record Keeping (p.11 para.23)

ASIC states that advisers should keep records of the personal advice provided to clients, based on the '*efficient honest and fair*' duty (s912A(1)(a)) and the duty to have adequate dispute resolution systems (s912A(1)(g)).

This would appear to be sensible, and good business practice. We question, however, whether it is really necessary to state this, given the existing licensing obligations. In particular, record keeping for advice is already covered in the standard conditions of the AFSL. Pro Forma 209 clause 57(b) – which presumably will be updated for the new Division 2 obligations - states:

> **Retention of Financial Services Guides, Statements of Advice and material relating to personal advice**
>
> *(This condition is imposed on all licensees and applies where licensees provide financial product advice to retail clients.)*
>
> 57. Where the licensee provides financial product advice to retail clients, the licensee must ensure that copies (whether in material, electronic or other form) of the following documents are retained for at least the period specified:
>
> …
>
> (b) a record of the following matters relating to the provision of personal advice to a retail client (other than personal advice for which a Statement of Advice ("SOA") is not required or for which a record of the advice is kept in accordance with subsection 946B(3A)):
>
> (i) the client's relevant personal circumstances within the meaning of subparagraph 945A(1)(a)(i); and
>
> (ii) the inquiries made in relation to those personal circumstances within the meaning of subparagraph 945A(1)(a)(ii); and
>
> (iii) the consideration and investigation conducted in relation to the subject matter of the advice within the meaning of paragraph 945A(1)(b); and
>
> (iv) the advice, including reasons why advice was considered to be "appropriate" within the meaning of paragraphs 945A(1)(a) to (c),
>
> for a period of at least 7 years from the date that the personal advice was provided;

We therefore question whether it is necessary to state in ASIC policy that record keeping obligations exist, *indirectly*, under the duty to act efficient honest and fairly and the dispute resolution provisions, when *specific* record keeping obligations already exist.

3. Perfect Advice not required (page 12 para.29)

We commend ASIC for stating that it is not expecting *perfect advice* to every client. This is consistent with Minister Shorten's comments in his *Second Reading Speech* on 24 November 2011, when the Minister stated that:

> The best interests duty does not require that advisers give the best advice. It does not invoke punishment if, with the benefit of hindsight, the advice does not prove to be perfect. It is not about guaranteeing clients the best investment returns on products. (Hansard at 13751)

As well as stating that the best interests duty does not requiring *perfect* advice, we also note the following in relation to the Minister's comments, namely –

a. that the wisdom of *hindsight* is not relevant in the assessment of whether the best interests duty was fulfilled, and
b. that there is no implication that investment returns are to be guaranteed.

4. Putting client in better position (Proposal B1 p.16)

In Proposal B1, ASIC expects that best interest duty '…*will result in the client being in a better position if the client acts on the advice provided*'. This concept is used frequently in CP182. However, we question whether this is really the aim of the best interests duty.

In his Second Reading speech on 24 November, the Minister made reference to the concept of clients being 'better off':

> Financial planners and those who work in the financial services industry implicitly understand that the brand of financial advice needs renewal following a string of collapses including Storm, Trio and Westpoint. I believe that the vast majority of financial planners do see their role as making their dealings with customers such that, after having dealt with the planner, the customer is better off than if the customer had never sought financial advice to begin with. (Hansard at 13751)

However, he then went on to set out two *key measures* that are *integral components* which *go to the heart of boosting professionalism*, namely the best interests duty and conflicted remuneration. As to the best interests duty, he states that it is really about acting in the client's best duty and not their own:

> Firstly, the bill imposes a statutory best interests duty on financial advisers. As its name suggests, the duty requires advisers to act in the best interests of their clients, and to put their client's interests ahead of their own. (Hansard at 13751):

In his *Second Reading speech* on 22 March 2012, the Minister described the best interest duty as follows:

> Third, the bills impose a statutory best interest duty on financial advisers. This will be a legislative requirement to ensure that financial advisers are focused on what is best for their clients. While this will ultimately lead to better advice in many cases, it is about regulating conflicts. It is not about regulating for the best investment return. As I have said previously in the House, the best interest duty does not require that advisers give the best advice. It does not require perfection in statements of advice by applying the benefit of hindsight. The duty strikes a balance between certainty and flexibility for the financial adviser. (Hansard at 4097)

The *Act* does not say that the provider must act in such a way as to *'…result in the client being in a better position if the client acts on the advice provided'.* It says that the provider must act in the *client's best interests*. The '*better position*' expectation of ASIC, drawing on the Minister's background comments, may not seem to be material, but it could become so. For example, it is not inconceivable that a Court or Tribunal, or more to the point FOS, could adopt the '*better position*' expectation as a <u>test</u> in deciding cases. For example, it may become part of the adjudicating authority's analysis of a case to ask: '*Was the client in a better position because of the provider's advice or service?'* The proper test under the Act should be *'Did the provider act in the client's best interests and not their own?'*.

Our Members are always concerned about ASIC overlaying the law with additional tests or obligations. We would submit that the '***better position test***' is already an example of this. Early in this consultation, we expressed concern that if the Courts or FOS adopted this approach, it would not be appropriate, because it would elevate a statement of ASIC's policy regarding a provision of the *Act* to the status of a regulatory or legal requirement. That is not the role of ASIC. Indeed, statements by ASIC and FOS officials at the recent FOS *Annual Conference* (16-17 October 2012) suggest that the '*better position test*' has already entered the vernacular and would be taken into account in the determination of disputes.

It is promising that ASIC already appears to be varying the approach to its '*better position test*'. ASIC has stated that it may qualify its '*better position test*' by saying something like (the advice) '…*will result in the client being <u>likely to be</u> in a better position if the client acts on the advice provided*'. However, it is not clear if this is materially different. ASIC has recently stressed that it says '*better position*', not '*better <u>financial</u> position*'. While financial is important, other factors can come into play e.g. they may better of if they are '*better informed*'. It is also clear that some form of temporal limitation needs to be placed on ASIC's test – i.e. *when* must they be in a better position? Short, medium, long term? Also, in any assessment of whether the client was

in a better position, prevailing market conditions should be taken into account, especially unforeseen economic conditions.

We are very concerned about ASIC's '*better position test*', and the fact that it already seems likely that forums like FOS will be using it. As noted above (at point 3), Minister Shorten when introducing the FOFA legislation stated that the 'best interests duty' –

> *'…does not invoke punishment if, with the benefit of hindsight, the advice does not prove to be perfect'.*

The Minister's description of the best interests duty appears to be balanced and properly based. However, ASIC's '*better position test*' will invite those reviewing advice or determining disputes about advice to make a **hindsight review**. It is clear from the wording of the best interests duty in the *Act*, supported by the comments of the Minister who introduced the legislation into Parliament, that this is not a requirement of the new FOFA best interests duty.

5. The 'Safe Harbour' in s961B(2) (p.17 para.45)

Section 961B(1) sets out the overarching best interests duty:

> '*The provider must act in the best interests of the client in relation to the advice...*'

Section 961B(2) then goes on to list the requirements to comply with Section 961B(1).

ASIC characterises Section 961B(2) – the list of obligations to meet the best interests duty - as a ***safe harbour***:

> ***Satisfying the safe harbour for the best interests duty***
>
> 45 Section 961B(2) contains a 'safe harbour' for complying with the best interests duty in s961B(1). If an advice provider can prove they have taken each of the steps listed in s961B(2), this is one way of demonstrating they have satisfied the best interests duty in s961B(1).

ASIC's characterisation of Section 961B(2) as a *'Safe Harbour'* is presumably intended to mean that if you comply with the list of requirements, you don't have to comply with the best interest duty. This is a novel analysis. In the debates leading up to the enactment of the Bill, none of the Bill's Explanatory Memoranda, Ministerial speeches or consultation papers describe this sub-section as a 'safe harbour'. In his Second Reading speech on 24 November 2011, Minister Shorten, after discussing the general best interest's duty, described what ASIC calls a 'safe harbour' as follows:

> By the same token, for the adviser that wants certainty around compliance above all else, the general obligation is supplemented by a provision setting out steps which, if satisfied, will be deemed sufficient for the adviser to have fulfilled the general obligation. (Hansard at 13751)

***Was AML/CTF the guide*?** It has been noted that the term 'safe harbour' is used in the *AML/CTF Rules*[1]. Under these rules, if clients are assessed as low or medium risk, lesser requirements apply. This is known as a 'safe harbour', because different rules apply, compared to those for high risk clients. Compared to FOFA, this is not a valid comparison, because a. AML/CTF Rules are rules, not just ASIC policy, and b. the best interests obligation still applies if what ASIC calls a 'safe harbour' applies – there is not a different requirement.

The introduction of the new concept by ASIC of a 'Safe Harbour' is not helpful to the understanding of the best interests duty, and is potentially confusing. We would submit that Subsection 961B(2) should be said to be a set of '***benchmarks***' rather than a '*safe harbour*'.

Once again we are grateful for the opportunity to provide these comments to ASIC on CP182. Thank-you also for the opportunity for our Members to discuss the proposals with senior officials recently. Should you require further information please do not hesitate to contact me or Doug Clark, Policy Executive dclark@stockbrokers.org.au .

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[1] *Anti-Money Laundering and Counter-Terrorism Financing Rules, Rule 4.2, made under the Anti-Money Laundering and Counter-Terrorism Financing Act 2006*