Stockbrokers Association of Australia
Incorporating SDIA

Senate Economics Legislation Committee

Further Inquiry into the provisions of the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014

Submission

15 September 2014

Introduction

The Stockbrokers Association of Australia is pleased to provide these comments to the Committee to assist its further consideration of the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill* 2014 (the '**Bill**'), particularly the further measures announced by the Government in July.

The Bill and accompanying Regulation[1] containing the Streamlining measures were generally **welcomed** by the Stockbrokers Association upon their release on 29 January 2014. The Streamlining measures 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.

[1] *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation* 2014

On 15 July 2014, the Government announced that it had achieved Senate support for the *FOFA Streamlining* package[2]. In the July Announcement, the Government stated that it had reached agreement with the Palmer United Party and other minority Senators to implement further measures within 90 days, including –

a. further improvements to the **Statements of Advice** provisions of the *Corporations Act 2001*; and
b. the establishment of an **enhanced public register of financial advisers**.

(The establishment of the enhanced public register of financial advisers is not included in the Bill. The Stockbrokers Association is pleased to be part of the AFSL Working Group which has recently finalised its recommendations in relation to new register. The Group is now working on proposals to improve professional standards.)

In this Submission, we would like to do the following –

A. to reiterate our comments on the following aspects of the principal reforms:

- Removing the 'catch-all' from the best interests duty
- Conflicted remuneration
- Accountants' Certificates, and
- Scaled advice; and

B. to raise three issues with the further measures on **Statements of Advice** which were announced in July.

A. COMMENTS ON THE PRINCIPAL STREAMLINING REFORMS

1. Removal of the 'Catch-all' from the Best Interests Duty (s961B(2)(g))

We are confident that the removal of the 'catch-all' from the best interests duty which has captured the interest of many commentators recently, will not detract from the effectiveness of the best interests duty. The best interests duty in section 961B remains a detailed and robust obligation to ensure that personal advice is suitable for the particular client. The 'catch-all' was only one of seven listed obligations in the best interests duty. Moreover, investor protection is strengthened by the obligation to give appropriate advice (s961G), and to ensure that the interests of the client are paramount (s961J). Accordingly, we strongly disagree with recent commentary that the removal of the 'catch-all' has somehow *removed* the best interests duty, or that it is substantially reduced.

[2] Senator The Hon Mathias Cormann Media Release: *Senate support for financial advice law improvements* 15 July 2014

2. Conflicted Remuneration

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 support the scope of FOFA being narrowed to its original intent. Financial advisers who 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.

3. Accountants' Certificate renewal period restored to 2 years (s761G(7)(c); Reg.7.6.02AF)

The Bill restores the 2 year renewal period for Accountants' wholesale client certificates, which was inexplicably reduced to 6 months by FOFA.

The reduction in the renewal period for Accountants Certificates from 2 years to 6 months was not flagged in the years of consultation leading up to FOFA's commencement on 1 July 2013. 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 without a prospectus. 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. Such clients do not require all of the disclosure and other obligations owed to a retail client. The certificates serve the same function in the context of advice as they do for share offers. Accordingly, there is no justification for two different renewal periods applying to Accountants' certificates in the two contexts.

4. 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.[3] (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.

We urge the Senate to pass the principal Streamlining Reforms in their entirety.

B. FURTHER MEASURES ON STATEMENTS OF ADVICE - July 2014

Under its agreement with the Palmer United Party and other Senate minority parties which was announced in July, the Government has committed to introduce the following changes to the SOA provisions of the *Corporations Act 2001*, which have now been added to the Bill:

1. ***Statement of Advice:***
   a. ***New Statements***: the SOA will be required to contain a number of **new statements**:-
      - that the adviser is required to act in the best interest of their client and prioritise their client's interests ahead of their own;
      - that the adviser genuinely believes that the advice provided is in the best interests of the client, given the client's circumstances;
      - disclosure of any fees to the adviser;
      - that the adviser will provide a fee disclosure statement annually, if the client enters into, or has entered into, an ongoing fee arrangement after 1 July 2013 ;
      - that where applicable, the client has the right to return financial products under a 14-day cooling-off period under current provisions of the *Corporations Act*;
      - that the client has the right to change his or her instructions to their adviser, if for example they experience a change in their circumstances.

      (While the obligation to make the above statements is new, the statements themselves appear to merely restate other obligations and rights currently under the *Act*, rather than introduce new ones.)

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

b. Signing of the SOA and amendments:

- The SOA is to be signed by both the client and the financial adviser; and
- Instructions by a client to alter or review their instructions, are to be in writing and signed by the client and acknowledged by the adviser.

We wish to point out some important practical issues with the Further Measures, which may detract from their efficacy' and increase the cost and complexity of service delivery for our Members and their clients, for **negligible benefit**.

The issues are in relation to the new requirement to have SOAs 'signed-off' by both the adviser and the client, and for any alteration of instructions by a client to be 'in writing' and 'signed by the client'.

Issue 1: Effect on Time-Critical SOAs and Further Advice

In stockbroking, in contrast to financial planning, much business is transacted over the telephone. Clients want real-time market and stock information and advice, and want to take action immediately, based on that advice. In relation to Statements of Advice, the law already acknowledges this, by permitting SOAs to be sent to clients up to **5 days after** the service is given, in time-critical situations[4]. This allows shares to be bought or sold straight away based on advice so as not to risk market movements during the time it would otherwise take to produce and send the SOA to the client. The current provision is sensible and facilitates timely advice to clients, with no loss of consumer protection. If clients need to sign and return all SOAs prior to trading, it may be contrary to the client's best interests. Moreover, such restrictions could significantly reduce trading volumes in a market whose volumes are already low.

The same can be said about the **further advice** provisions of section 946B[5], which provide that an SOA need <u>not</u> be given, where there has been no significant change in the client's circumstances or the basis of advice, since the last SOA was given.

These two provisions of the Act came into effect with the Financial Services Reforms in 2004. They have proven very effective for both advisers and their clients, especially those who invest in listed securities.

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[4] *Corporations Act 2001* section 946C Timing of giving Statement of Advice

…
Time critical cases
(3) If:
(a) the client expressly instructs that they require a further financial service that arises out of, or is connected with, the advice to be provided immediately, or by a specified time; and
(b) it is not reasonably practicable to give the Statement of Advice to the client before that further service is provided as so instructed;
the providing entity must give the client the Statement of Advice:
(c) unless paragraph (d) applies *[cooling off period – not applicable to listed securities]* —within 5 days after providing that further service, or sooner if practicable…

[5] As amended by *Corporations Regulation* 7.7.10AE (20 Dec 2005)

We therefore strongly oppose any further measures that would detract from or interfere with the *time-critical* provisions of section 946C(3)(c), or the *further advice* provisions of section 946B, which have proven useful and effective in the provision of advice to retail clients for over 10 years.

Issue 2: Signing-off in General

As described above, most advice in stockbroking is given over the telephone. Record-keeping and other requirements ensure that clients' interests are protected and the best interests duty followed. Unlike other sectors like financial planning, stockbrokers are supervised by ASIC under the *Market Integrity Rules* and are subject to much more rigorous regulation than other sectors. The new requirement to have SOAs and changes in instructions signed-off by Clients will be revolutionary to the operation of stockbroking businesses. There is no evidence that there is a problem with the current system. This is borne-out by the number of complaints against stockbrokers to the Financial Ombudsman Service, which is low and trending lower since the GFC[6].

The sign-off requirement will not increase consumer protection. It appears to be an over-reaction which has not been properly considered.

Accordingly, we submit that any new requirement to have SOAs 'signed-off' by both the adviser and the client, and for any alteration of instructions by a client to be 'in writing' and 'signed by the client' will not increase consumer protection, but will detract from retail clients receiving affordable, high quality financial advice, and will create unnecessary and costly red tape.

At the very least, if the new measures are to proceed, to avoid the cost and inconvenience of having to send hard copy documents to clients and to ensure their receipt, there should be nothing preventing the documents to be sent and 'sign-offs' to be given **electronically**.

(We note that this submission is consistent with the *Financial System Inquiry's* interim report recommendations to amend references in the law that are not technology-neutral and that regulatory settings should enable electronic service delivery as a default position[7].)

Issue 3: Clients who do not Sign and/or Return the SOA

A very practical issue that needs to be considered in any provision requiring documents to be signed or acknowledged by clients is what happens if a client fails to sign and/or return them to the licensee. Traditionally, the return rate for such an exercise can be low. Does the advice lapse? Should there be a time limit? What if the client cannot be contacted? In

[6] At the 2014 Annual Stockbrokers Conference in May, FOS Ombudsman Alison Maynard released the latest statistics on stockbroking complaints for the year to 30 April 2014. As the following figures show, the downward trend in complaints against stockbrokers post-GFC has continued:

Total disputes accepted against stockbrokers
1 May 2012 to 30 April 2013 – 62
1 May 2013 to 30 April 2014 – 51 (↓18%)

Not only has the number of complaints continued to fall, but the dollar value of the amounts claimed is low, with the vast majority of claims (71%) being for amounts between $0 and $50,000.

[7] Australian Government - Financial System Inquiry *Interim Report* July 2014, Chapter 4

rapidly changing market conditions, stockbrokers are not able to guarantee future price movements in stocks that are the subject of an SOA, and therefore should not be bound by the advice contained in an SOA for an unreasonable time into the future. This is a very problematic area, and could lead to great uncertainty for clients and advisers alike - and unnecessary complaints - unless it is properly constructed.

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Industry has made a long and at times difficult transition to FOFA. FOFA only commenced on 1 July 2013, with provisions being introduced during the transitionary period up to 1 July 2014. Certainty is now needed as to the final position, and there needs to be a period of time for the whole new system to be allowed to bed-down. 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.

We would be happy to address the Committee further on any of the matters raised in this Submission. Should you require further information, please contact me, or Doug Clark, Policy Executive dclark@stockbrokers.org.au .

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STOCKBROKERS ASSOCIATION OF AUSTRALIA
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