Submission to the Senate Economics Legislation Committee

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

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Introduction

This submission addresses the proposed changes in the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014.

The proposed reforms in the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 should be reconsidered as they remove a number of essential protections available to consumers.

General Observations

The Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 aims to reduce compliance cost for small businesses, financial advisers and consumers who access financial advice. While such an aim is admirable, the proposals put forward remove essential protections to consumers and unwind the FOFA reforms implemented by the previous government.

The observations made in this submission can be summarised in the following manner:

- Support the removal of 'opt-in' provisions if it is too costly for the industry;
- Reject the proposal to make fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013;
- Reject the alteration of the best interest obligation; and
- Reject the removal of the ban on conflict remuneration for general advice.

'Opt-in' and ongoing fee arrangement provisions

This submission supports the removal of the opt-in provision if the cost of applying it is too high. However, it is important to note that the current 'opt-in' provision ensures that a dialogue continues between the financial advisers and their clients – a dialogue that would stop financial advisers from charging consumers for services they are not receiving.

A change to the fee disclosure statement provisions is not needed. Such disclosure is desired as it provides the clients with extra protection. All current retail clients of financial advisers who have an ongoing fee arrangement should receive a fee disclosure statement to promote the transparency of the system and enhance consumer confidence. This obligation enhances the transparency of dealings between advisers and their clients. It also limits abuses in the system.[1] Additionally, it may be costly and confusing for advisers to keep too separate regimes of disclosure applicable in their organisation.

Further, limiting the fee disclosure statement to certain people may raise the following questions:

- Is the fee disclosure statement valuable and needed? Doubt about the value of the fee disclosure statement may arise in the mind of consumers if only certain investors receive it;

- Why are investors who entered into an arrangement prior to 1 July 2013 not subjected to the same protections as investors who have entered into an arrangement after 1 July 2013? A double standard should not be created and supported by the statute. All investors who have current arrangement with a financial adviser should receive the fee disclosure statement.

Transparency and accountability should be the centre of any reform in the area of financial services and not the interest of businesses. The legislation should protect the most vulnerable members of our society especially when bad investments generated from bad advice may lead investors to lose their life savings.

Best Interests Obligations

- **Provision: s 961B(2)**

Section 961B(2) of the *Corporations Act 2001* (Cth) requires financial advisers to fulfil certain steps to ensure that they are acting in the best interest of their clients when giving advice. These steps create a safe harbour for financial advisers.

When considering the steps outlined in this provision, it is important to find the right balance between the protection of consumers and the burden imposed on financial advisers. It is important to remember that stringent regulation is designed to cope with 'bad apples' and unusually hard cases, which in reality constitute a minority of all the problems in the domain of regulatory supervision. Most financial advisers, being 'good apples', may accordingly be subjected to unreasonable regulation if s 961B imposes too harsh a regulation. If this is the case, the provision will appear even more unreasonable to the industry because it may raise the costs of business, leading to lost opportunities for the progress of that business.[2]

However, the current steps outlined in s 961B(2) are essential and do not add an unreasonable burden on the industry. Section 961B(2)(g) is important as it acknowledges that 'one size does not fit all': the advice needed by a client may vary from one situation to the next and as such the steps that may be taken by the adviser to ensure that the advice is for the best interest

[1] A recent study on the satisfaction of clients with financial advisers highlighted that 17% of the clients surveyed did not receive any update from their financial advisers on yearly basis. The introduction of the proposed disclosure obligation will remedy such situations: Kym Irving, Gerry Gallery, Natalie Gallery and Cameron Newton, 'I Can't Get Satisfaction... Or Can I? A Study of Satisfaction with Financial Planning and Client Well-Being' (2011) *Finsia Journal of Applied Finance* 39.
[2] Eugene Bardach and Robert A Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (Temple University Press, 1982), 92-93.

of the client may be different. Further, the language of the paragraph makes clear that the relevant steps that may be taken are to be determined when the advice is provided and not in hindsight. Accordingly, the provision does not impose an unreasonable burden on financial advisers.

Providing adequate financial advice is essential as such an obligation does not only enhance confidence in the financial planning industry but it also has an impact on consumers' well-being.[3] As a result, the steps required by s 961B(2) should not be watered down. The interest of consumers should prevail.

- **Provision: s 961E**

Section 961E provides the necessary clarification for s 961B(2)(g) and as such should not be repealed. It ensures that the best interest consideration under s 961B(2)(g) is assessed objectively and accordingly do not impose an unreasonable burden on the industry.

Conflicted remuneration and other banned Remuneration

Provisions regarding conflicting remunerations currently apply to general and personal advice. The Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014 limits the application of conflicting remunerations to personal advice.

Such a limitation should not be introduced. On one hand, the existing coverage of the provision does not add a financial burden on advisers: it affects their remuneration. On the other hand, consumers' protection dictates that conflicting remuneration should not be allowed as consumers should be able to expect that the advice given to them is an unbiased advice. Receiving a commission in return for advice may dampen the public confidence in the sector especially in view of the financial scandals that took place during the financial crisis.

Limiting the conflicting remuneration for personal advice is not desired as:

- it motivates advisers to provide their clients with general instead of personal advice because this will enable them to receive financial benefits;

- consumers seeking general advice should be protected. The proposed change regarding conflicting remuneration will remove one of the key protections available to them: receiving unbiased advice. This is problematic as most consumers would be seeking general advice from their adviser.

- There are already exemptions in place that allow advisers to receive benefits. There is no need to expand the list.

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[3] Kym Irving, Gerry Gallery, Natalie Gallery and Cameron Newton, 'I Can't Get Satisfaction... Or Can I? A Study of Satisfaction with Financial Planning and Client Well-Being' (2011) *Finsia Journal of Applied Finance* 36.

Consumers' interest in this matter and not the personal interest of financial advisers should be put first as consumers are vulnerable and have the most to lose if they are provided with bad financial advice.

Conclusion

The initial FOFA reforms aimed to protect consumers. The current Bill seems to go against this objective. The balance between the protection of consumers and the protection of business appears to have shifted toward the interest of businesses. With respect, this is the wrong stance as consumers and not businesses should be at the heart of financial services reforms: consumers have the most to lose if they are provided with bad advice. The proposed reforms seem to ignore the magnitude of the adverse effect that bad financial advice may have. Further, in Australia, consumers are compelled to invest through superannuation schemes and as such they will have to seek financial advice from financial advisers. The majority of these consumers have low financial skills[4] and their protection should be paramount to ensure confidence in the sector – a confidence that has been shaken as a result of the collapse financial providers such as Storm Financial, Opes Prime – remains.

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29 April 2014

[4] Australian Bureau of Statistices, *Retirement and Retirement Intentions* (Australia, 2011) < http://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/6238.0Main%20Features3July%202010%20to%20June%202011?opendocument&tabname=Summary&prodno=6238.0&issue=July%202010%20to%20June%202011&num=&view=>; Annamaria Lusardi and Olivia Mitchell, 'Baby Boomer Retirement Security: the Roles of Planning, Financial Literacy, and Housing Wealth' (2007) 54 *Journal of Monetary Economics* 205; Tullio Jappelli, 'Economic Literacy: An International Comparison' (2010) 120(584) *The Economic Journal* F 429; Annamaria Lusardi and Olivia Mitchell, 'Financial Literacy and Retirement Preparedness: Evidence and Implications for Financial Education' (2007) 42(1) *Business Economics* 35; Maarten Van Rooij, Annamaria Lusardi and Rob Alessie, 'Financial Literacy and Retirement Planning in the Netherlands' (2011) 32(4) *Journal of Economic Psychology* 593;J Conrad Glass Jr and Beverly B Kilpatrick, 'Gender Comparisons of Baby Boomers and Financial Preparation for Retirement' (1998) 24(8) *Educational Gerontology* 719.