

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 235

Topic: Regulation of Financial Advisers

Hansard Page: Written

Senator BUSHBY and EGGLESTON asked:

- 1. With regard to reforms announced by the Government in April with regard to the regulation of financial advisers, can ASIC advise what steps it has taken so far to assume the regulation of advisers, and the budgetary cost this has had?**

ASIC already regulates financial advisers through the licensing, conduct and disclosure provisions in the Corporations Act, but has not sought to implement the proposed reforms announced by the Government in April as the government is still consulting on its implementation of those reforms and the legislation that supports the changes has not yet passed through Parliament. ASIC is participating in this process and has met regularly with Treasury. There has been no budgetary cost associated with the proposed changes at this stage.

- 2. How many financial advisers currently operate within the industry with a Financial Services Licence? Does ASIC know how many of these advisers charge fees in a manner that will be banned by the Government?**

As at 13 July 2010 there are 3281 firms licensed to provide personal financial advice. ASIC does not know how many of these advisers and advisory firms charge fees in a manner that would be banned under the potential reforms announced in April, as this information is not reported to us. We understand that many firms are currently reviewing and revising their remuneration models.

- 3. Was it ASIC's opinion that a statutory fiduciary duty was required to be placed on a financial advisers? Is it not the case that a fiduciary duty already exists at common law?**

The question of whether or not a fiduciary-style duty is required for financial advisers is a matter for Government policy. In its submission to the PJC Inquiry ASIC stated that it "believes that the Government should assess whether the following changes would improve access to quality advice: (a) clarifying the standard of care for advisers by introducing a legislative, fiduciary-style duty ... These changes would help create a professional advice industry delivering quality advice and should increase retail investor confidence in the advice industry, leading more retail investors to seek advice" (para 136).

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Some financial advisers are already subject to common law fiduciary duty, however the application and scope of this duty is not clear. It relies on case law which is contested and thus results in a lack of certainty for industry and consumers. For example, it is not clear that all financial advisers would be under a fiduciary duty at all times. In addition, parties may agree by contract that the common law duty is not to apply, which is unsatisfactory from a consumer perspective. By contrast, a statutory duty would be binding and unable to be altered by contract.

4. Does ASIC agree with the Government's view that increased disclosure does nothing to prevent inappropriate advice being given to investors from advisers?

The effectiveness of any increased disclosure would depend on the exact nature of the particular requirement. In its submission to the PJC Inquiry ASIC noted that disclosure can be ineffective because of the length and complexity of some documents, limited consumer engagement and understanding and the mixed or competing purposes of disclosure. Further, the current law does not rely on disclosure alone to deal with issues of inappropriate advice. For example, Ch 7 of the Corporations Act requires that personal advice be appropriate as well as properly disclosed.

5. In ASIC's view, who will determine whether there is a reasonable belief that an adviser may not comply under a license (refer Recommendation 8 of the Ripoll Report)?

The answer to this question will depend on the exact drafting changes (if any) that are proposed to the Corporations Act. Recommendation 8 of the PJC Report provides "The committee recommends that sections 913B and 915C of the Corporations Act be amended to allow ASIC to deny an application, or suspend or cancel a licence, where there is a reasonable belief that the licensee 'may not comply' with their obligations under the licence." S913B and 915C current refer to ASIC having a reasonable belief about the matters in those sections, and we do not understand the proposal to alter who or what agency has to form the relevant belief. That is, ASIC's role will be to consider the circumstances and, where appropriate, form the relevant reasonable belief.

6. The law as proposed will allow ASIC to take action against an adviser before any detriment is made. How does ASIC see this as affecting the onus of proof burden? Will an adviser be forced to prove that his or her practices will comply with the license?

This will depend on the exact drafting changes (if any) that are proposed to the Corporations Act.

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As we understand the proposal, it would mean that ASIC could refuse or cancel a licence if it held a reasonable belief that the relevant person 'may not' comply with their obligations.

As ASIC explained in its submission to the PJC Inquiry, "ASIC believes the Government should consider the merits of slightly modifying the requirements for granting and removing AFS licences in order to enhance ASIC's ability to protect investors. This could be achieved by replacing the current licensing 'entry' requirement, that ASIC have no reason to believe the licensee 'will not comply' with their obligations under s912A in the future, with the slightly lower standard of 'may not comply' or 'is not likely to comply' with their obligations in the future."

This change would overcome the difficulty ASIC currently experiences when trying to assess whether an applicant will comply with their obligations and meet their licence conditions before they commence business. The slightly lower standard proposed above (i.e. 'may not comply' or 'is not likely to comply') would enable ASIC to consider a wider range of matters than currently permitted and minimise this difficulty.

This requirement (i.e. 'may' or 'is likely' not to comply with their obligations) could also be introduced as a basis for cancelling or suspending AFS licences after a hearing. ASIC has found it difficult to establish before the AAT that a licensee will not comply with obligations in the future and this limits ASIC's ability to act prior to a breach.

The National Consumer Credit Protection Act contains similar licensing requirements to grant and cancel credit licences. The Explanatory Memorandum to the Act notes that the requirement for ASIC to have a reason to believe that the credit licensee will not comply with the legislation would require ASIC 'to believe, as a matter of certainty, that the applicant will contravene the obligations in the future' and notes that '[s]uch a standard would be so onerous that it could result, in practice, in ASIC never being able to refuse a credit licence'. ASIC's experience under the AFS licensing regime has informed this conclusion: see *Saxby Bridge Financial Pty Ltd and Ors and ASIC* [2003] AATA 480." (paras 87-90)

Where the adviser is a representative rather than a licensee, the banning power may be more relevant than the license cancellation power (s915C). In Recommendation 10 of the Report the committee "recommends that section 920A of the Corporations Act be amended to provide extended powers for ASIC to ban individuals from the financial services industry".

ASIC does not understand the recommendation to change the onus of proof or require an adviser "to prove that his or her practices will comply with the license". Rather, it would provide a broader test and allow ASIC to consider a wider range of circumstances when considering whether to grant (or cancel) a

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licence. [It would mean that a formal finding by a court that there had been a breach would not be necessary before a licence could be suspended or cancelled (eg it would allow ASIC to take into account issues of training and competence in deciding whether to grant a licence).]

7. What level of investigation does ASIC perform on advisers before granting a financial services licence? Is this level of investigation enough to determine whether an adviser can comply with the license? Can this be strengthened in any way?

ASIC has a statutory obligation under section 913B of the Corporations Act to form a view about:

- the ability of an applicant for a financial services licence to comply with the obligations under s912A if the licence is granted (the licensee obligations);
- the good fame and character of the people nominated by the applicant as being responsible for significant day-to-day decisions about its financial services business (Responsible Managers); and
- the ability of an applicant to satisfy any other prescribed requirements.

The application form (FS 01) asks a series of questions intended to allow ASIC to form a view about these criteria. ASIC then asks for more detailed supporting information that focuses on the applicant's organisational competence, the good fame and character of its Responsible Managers, and its financial statements and financial resources.

In assessing the organisational competence of an applicant, ASIC looks at the individual competence of the Responsible Managers to determine whether they have an appropriate combination of qualifications and experience that are relevant for the nature of the business intended to be performed by the applicant under an AFSL. ASIC's policy approach to organisational competence is set out in Regulatory Guide 105 'Licensing: Organisational competence'.

ASIC's consideration of the good fame and character of each of an applicant's Responsible Managers is based on four elements, provided by the applicant:

- a Statement of Personal Information, which is a series of questions about the conduct of the person over the previous ten years;
- a national criminal history check;
- a bankruptcy check; and
- two business references.

ASIC also conducts searches of its internal databases, to determine whether any relevant information is already known.

Finally, ASIC assesses the applicant's ability to satisfy the financial requirements ASIC will place upon it by way of licence condition. ASIC's financial requirements are detailed in Regulatory Guide 166 'Licensing: Financial

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requirements'. Some applicants for an AFSL are also asked to provide additional supporting documentation, further probing the ability of the applicant to satisfy the licensee obligations. Applicants are chosen for this additional scrutiny through an assessment of the regulatory risk of the applicant.

The assessment performed by ASIC is sufficient to form a view that an applicant has the ability to comply with the licensee obligations, based on the answers provided in the application form and the supporting documentation provided.

8. If ASIC grants a license to an adviser where there is a reasonable belief that the licensee may not comply, isn't ASIC the body responsible for granting that license?

ASIC, as the licensing authority for AFS licensees, is responsible for granting and where necessary cancelling licences. The circumstances in which ASIC can refuse a licence or cancel an existing licence are limited by the Act. At present holding a "reasonabl[e] belief that the licensee may not comply" is not one of the grounds for refusing or cancelling a licence.