Chapter 2

Provisions of the Bills

2.1 This chapter outlines the provisions of the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011.

2.2 These two Bills provide for the implementation of the Future of Financial Advice (FOFA) government reforms first announced by the then Minister for Financial Services, Superannuation and Corporate Law, the Hon. Chris Bowen MP, on 26 April 2010.

2.3 The Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, summarised the purpose of the reforms:

> It is a concern that only one in five Australians access financial advice. These reforms will restore trust and confidence in the sector following collapses such as Storm, Westpoint and Trio. They also remove the red tape that has prevented low-cost, good quality advice being delivered to millions of Australians.[1]

2.4 Most provisions of the Bills will only apply to clients who receive financial advice from the licensee on or after the commencement day of 1 July 2012.[2] However, there are some exceptions, such as some fee disclosure requirements[3] and the best interests obligations, which apply to all clients from 1 July 2012, regardless of when they first sought advice.

Corporations Amendment (Future of Financial Advice) Bill 2011

2.5 This Bill would amend the *Corporations Act 2001* to:

- require financial advisers to provide a fee disclosure statement to a client when charging advice fees for longer than 12 months;
- require financial advisers to provide a fee disclosure statement and a renewal notice to a client when charging advice fees for longer than 24 months; and

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1 The Hon. Bill Shorten, MP, Minister for Financial Services and Superannuation, 'Future of Financial Advice Reforms—Draft Legislation', *Media Release* 127, 29 August 2011.

2 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 15. See also Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962D.

3 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, sections 962R and 962S.

- extend the Australian Securities and Investments Commission's (ASIC) licensing and banning powers used to supervise the financial services industry.

2.6 The Explanatory Memorandum (EM) for the Bill states that:

> The compulsory disclosure and renewal notice obligations will apply to advisers ('fee recipients') in situations where they provide personal advice to a retail client, and the client pays a fee which does not relate to advice that has already been given at the time the arrangement is entered into. This is so the compulsory disclosure and renewal notice obligations apply to ongoing advice fees.[4]

Main provisions of the Bill

Ongoing fee arrangements

2.7 The new provisions for ongoing fee arrangements are set out under *Schedule 1, item 10, division 3*. The Bill defines 'ongoing fee arrangements' (section 962A) and puts in place arrangements that will require financial advisers to obtain their retail clients' agreement every two years to charge them ongoing fees for financial advice (the opt-in requirement).

2.8 For the purposes of this Bill, instalment plans will not be considered as 'ongoing fees'. This is to prevent retail clients from 'opting out' of paying for services already rendered by an adviser.

2.9 The definition of ongoing fees also excludes insurance premiums and fees prescribed as 'product fees'. Product fees will be described in regulations yet to be released. The Minister will have the power to exclude certain arrangements that this Bill is not intended to apply to, including arrangements that do not currently exist. The EM states that this is to ensure that the legislation is kept up to date and effective.[5]

Termination, disclosure and renewal

2.10 The provisions relating to contract termination, disclosure and renewal obligations establish a framework by which retail clients are given the opportunity to renew their ongoing fee arrangements with their financial service providers. It is envisaged that this framework will also encourage greater client engagement by providing greater awareness of the costs and structure of the financial advice received.

2.11 Consistent with current legislation, section 962E stipulates that a retail client will be able to terminate an ongoing fee arrangement at any time, without being

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4 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 7.

5 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 8.

charged a termination fee (except where the client is liable for services already rendered).

2.12 Section 962G provides that fee recipients (as defined in section 962C) will need to provide a fee disclosure statement within 30 days of the 12 month anniversary of the date the arrangement was entered into.

2.13 The required information for fee disclosure statements are outlined in subsection 962H(2). Under these provisions, the fee recipient will need to disclose the amount of ongoing fees charged for the previous 12 months and also the anticipated fees for the upcoming 12 months.

2.14 The provisions stipulate that the nature of the services provided must also be detailed. This includes an outline of services received in the 12 months prior to the disclosure day, and also the services that will be rendered in the forthcoming 12 months, commencing on disclosure day (the day of the 12 month anniversary of the arrangement, see section 962J).

2.15 Subsection 962H(3) will allow regulations to provide details of any other prescribed matters to be included in the fee disclosure statement. Regulations may also provide that certain information is not required to be contained in a fee disclosure statement. The EM states that this regulation-making power serves:

> ...several functions, including keeping the legislation up to date, providing commercial certainty quickly and efficiently to industry participants, and to provide efficacy to the legislation.[6]

2.16 Importantly, if a fee recipient does not provide a fee disclosure statement within the required timeframe, the client will not be liable to continue paying the ongoing fee.

2.17 Conversely, if a breach of the fee disclosure requirements occurs and the client continues to pay ongoing fees, the fee recipient is not obliged to refund any fees.[7] It is important to note that the client is not taken to have waived their rights or to have entered into a new arrangement by merely continuing to pay an ongoing fee after a breach of the disclosure obligations.[8]

2.18 Section 962K stipulates that if an ongoing fee arrangement is to remain in place for a period longer than 24 months, the fee recipient must provide the client with

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6 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 9. This section also applies to renewal notices in subsection 962K(3).

7 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

8 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

a renewal notice and a fee disclosure notice within 30 days beginning on the 24 month anniversary of the last day on which that arrangement was agreed to/renewed.

2.19 Subsection 962K(2) sets out the information that must be included in a renewal notice. It is envisaged as a simple form and fee recipients will have flexibility in its presentation. The renewal notice will provide the client with the opportunity to renew their ongoing fee arrangements and it will also set out the consequences should a client elect not to renew the arrangement. If the client does not renew their arrangement, they will lose access to ongoing advice. The fee recipients may choose to include further information in the renewal notice elaborating on the consequences of termination.

2.20 The fee disclosure statement that will be included with the renewal notice will assist the client in assessing whether or not to renew the arrangement.

2.21 Consistent with disclosure obligations, if a client does not notify the fee recipient of his or her intentions, their ongoing arrangement will be terminated at the end of another 30 day period, following the renewal period (section 962N). If a fee recipient does not provide a renewal notice and fee disclosure statement within the required timeframe, the client will not be liable to continue paying the ongoing fee.[9]

2.22 If a client fails to comply with the disclosure obligation and continues to pay ongoing fees, the fee recipient is not obliged to refund any moneys.[10] On the other hand, the client is not taken to have waived their rights or to have entered into a new arrangement by merely continuing to pay an ongoing fee after a breach of the disclosure obligations.[11]

Changes to the Australian Security and Investment Commission's (ASIC's) powers

2.23 The first tranche of the FOFA Bills amends ASIC's licensing and banning powers so as to enhance its ability to supervise the financial services industry. The Bill has a particular focus on individuals: currently ASIC only has the ability to prosecute licensees, not individual advisers, which means individuals providing poor advice may still continue to operate. Under the new provisions, ASIC will have the power to ban these individuals.

2.24 The enhancements to ASIC’s licensing and banning powers are:

9 Corporations Amendment (Future of Financial Advice) Bill 2011, Subsection 962F(2).

10 Corporations Amendment (Future of Financial Advice) Bill 2011, Schedule 1, item 10, section 962F.

11 Corporations Amendment (Future of Financial Advice) Bill 2011, Subsection 962F (3).

- a change to the licensing threshold so that ASIC can refuse or cancel/suspend a licence where ASIC has a reason to believe a person is likely to contravene (rather than will breach) its obligations;[12]
- extend the statutory tests so that ASIC can ban a person (as opposed to entities) who is not of good fame and character or not adequately trained or competent to provide financial services (in essence they are not a fit and proper person);[13]
- ensure that ASIC can consider any conviction for an offence involving dishonesty that is punishable by imprisonment for at least three months, in having a reason to believe a person is not of good fame and character for licensing and banning decisions;[14]
- a change to the banning threshold so that ASIC can ban a person if ASIC believes they are likely to (rather than will) contravene a financial services law;[15] and
- clarification that ASIC can ban a person who is involved, or is likely to be involved, in a contravention of obligations by another person.[16]

2.25 Moreover, section 965 prohibits advisers from entering into an agreement with a client that would attempt to void their obligations under the package of FOFA amendments.

Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

2.26 In addition to the Corporations Amendment (Future of Financial Advice) Bill 2011, this Bill would amend the *Corporations Act 2001* to:

- require financial advisers to act in the best interests of their clients and to put their client's interests ahead of their own when providing advice;
- ban the payment and receipt of certain remuneration which has the potential to influence the financial product advice given to retail clients;
- ban volume-based shelf-space fees from asset managers or product issuers to platform operators; and
- ban asset-based fees on borrowed client monies.

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12 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 913B(1)(b), 920A(1)(aa).

13 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 920A(1(c)

14 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 913B(4)(a), 920A(1)(g)(h).

15 Corporations Amendment (Future of Financial Advice) Bill 2011, Subparagraph 920A(1)(aa).

16 Explanatory Memorandum, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 20; 920A(1)(1A)(1B).

Provisions of the Bill

2.27 This Bill will introduce two key measures: imposing a statutory best interests duty on financial advisers; secondly, banning conflicted remuneration including commissions from product issuers.

Best interests duty

2.28 In the Second Reading Speech, the Minister for Financial Services and Superannuation, the Hon. Bill Shorten MP, stated:

> The best interests duty is a legislative requirement to ensure the processes and motivations of financial advisers are focused on what is best for their clients. It is true that this will ultimately lead to better advice in many cases, but first and foremost it is about regulating conflicts, not the intrinsic value of the advice provided.[17]

2.29 The Bill requires individuals providing advice to retail clients to prioritise the best interests of their clients in the event of conflict between the interests of the client and the interests of the licensee or the individual providing advice.

2.30 The best interest obligations are set out in Schedule 1, item 23, Subdivision B, Division 2 of Part 7.7A of the Bill and are intended to apply to individual advisers (including advisers issuing advice through computer programs)[18], as well as licensees and authorised representatives. This new focus on individuals provides a clear standard for all advisers. It also enables the industry regulator to ban individuals who provide poor quality advice.

2.31 In addition to the general best interests duty contained in subsection 961B(1), the Bill also sets out a number of steps advisers will need to take so as to ensure compliance with the best interests duty requirements. The EM notes that this list is not intended as an exhaustive checklist, but is an 'indication of what, as a minimum, is expected of providers in order to be considered to have acted in the best interest of the client'.[19]

2.32 Provisions in the Bill replace existing requirements in the Corporations Act to have a reasonable basis for providing advice and to warn clients if advice is premised upon incomplete or inaccurate information with the following obligations:

- to clarify the relationship between the new best interest obligations and these requirements; and

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17 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 24 November 2011, p. 13751.

18 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, Division 2, subsection 961(6).

19 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 10.

- to impose these requirements on the individual who provides the advice.[20]

2.33 Should an individual adviser breach their obligations, penalties for the breach will be imposed against the licensee or authorised representative. The 'individual adviser may also face administrative action in the form of a banning order'.[21]

2.34 The new Bill takes considerable care in explaining the notion of 'reasonableness', which features prominently in the provisions. For example, it requires that advisers conduct 'reasonable investigations' to verify/obtain information provided by the client and to ensure that the correct financial products are recommended, conducive with the client's best interests.[22]

2.35 The phrase 'reasonably apparent' also features prominently. This phrase relates to the obligation of advisers to conduct reasonable inquiries to obtain complete and/or accurate information where it is reasonably apparent that the information provided by a client is incomplete and/or inaccurate.[23] The test for what may be reasonably apparent is determined by what would be apparent to an individual with a reasonable level of expertise in the subject matter of the advice. It is intended as an objective test reliant upon professional standards in the industry.

2.36 If, after reasonable inquiries, client information remains inaccurate or incomplete, advice can still be given, however, the adviser is obliged to warn the client.[24]

2.37 The new Bill seeks to recognise that advice relating to basic banking products and general insurance are better understood by consumers and are relatively simple in nature. Consequently, a modified best interest obligation is applicable.[25]

2.38 The committee notes that there is an apparent error in paragraph 1.54 of the EM to the Bill, which relates to the best interests provisions. Twice in paragraph 1.54 references are made to subsection 961C(1), when this should in fact be subsection 961B(1).

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20 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 7.

21 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 7.

22 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, section 961D.

23 See Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, Division 2, Subdivision B, paragraph 961B(2)(c) and sections 961C and 961D.

24 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, section 961H.

25 Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, Schedule 1, item 23, division 2, subdivision B, paragraphs 961B(2)(a), (b) and (c).

Conflicted remuneration and other banned remuneration

2.39 Schedule 1, item 24, Divisions 4 and 5 will amend the Corporations Act to:

> ...ban the payment and receipt of certain remuneration which has the potential to influence the advice licensees provide to retail clients in respect of certain financial product advice.[26]

2.40 'Conflicted remuneration', defined in section 963A of the Bill, includes any monetary or non-monetary benefits given to a licensee or adviser that could reasonably be seen to influence the nature of financial advice provided to retail clients. Payments banned include commissions, volume payments from platform operators[27] to financial advice dealer groups and volume-based shelf-space fees payed by funds managers to platform operators (section 964A). However, section 963L provides that licensees, advisers and platform operators may receive volume-based payments if they can prove that the benefit is not conflicted remuneration.

2.41 Section 963L is particularly important in instances where performance pay constitutes an important part of a remuneration package. The EM states that:

> If an employee is remunerated based on a range of performance criteria, one of which is the volume of financial product(s) recommended, the part of the remuneration that is linked to volume is presumed to be conflicted. However, if it can be proved that, in the circumstances, the remuneration could not reasonably be expected to influence the choice of financial product recommended, or the financial product advice given, to retail clients (section 963A), the remuneration is not conflicted and is not banned.[28]

2.42 Section 963B of the Bill sets out the exemptions from the ban on conflicted remuneration. Paragraph 963B(1)(a) states that benefits given to a licensee or representative solely in relation to a general insurance policy is not considered conflicted. Moreover, in the case of a benefit received from a life insurance company, it is not considered conflicted if the policy relates to individual life risk policies within non-default superannuation funds and on life risk policies sold outside superannuation.

2.43 Additionally, if a benefit or commission is received in relation to an execution-only sale or issue of financial products, it is not considered conflicted

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26 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 23.

27 Retail investment platforms provide a central hub for investors to access a range of investment products, and allow for consolidation of client information and reporting on these assets.

28 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 28.

remuneration. Execution-only sales are where a product is sold with no advice provided to the retail client.[29]

2.44 Section 963A sets out the exceptions to the ban on soft-dollar benefits. Exceptions include benefits given in relation to a general insurance product, benefits under an amount prescribed by regulation (proposed to be $300), benefits with an education or training purpose (to be clarified in regulation), or benefits that provide information technology software or support.

2.45 The Bill will also ban asset-based fees on borrowed amounts.[30]

2.46 Section 964F defines asset-based fees as a fee for providing financial advice that is dependent upon the amount of funds to be used to acquire/buy financial products. A 'borrowed amount' refers to an amount borrowed in any form, secured or unsecured. An exemption is provided if it is not reasonably apparent to the licensee or adviser that the monies used by a retail client are borrowed. The EM states that the test for:

> ...whether something is "reasonably apparent" is an objective one, based on whether it would be apparent to a person with a reasonable level of expertise in the subject matter of the advice, exercising care and assessing the client's information objectively. It is a question of what would be apparent to a prudent adviser.[31]

2.47 Part 7.7A of the Bill sets out the provisions which are subject to civil penalties if breached. The Bill will establish maximum civil penalties of $200,000 for an individual or $1,000,000 for a body corporate.

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29 Schedule 1, item 24, division 4, paragraph 963B(1)(c).

30 Schedule 1, item 24, division 5, subdivision B.

31 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 37.