Chapter 4

Views on the introduction of a statutory 'best interests' duty for financial advisers

4.1 One of the central recommendations of this committee's 2009 report, *Inquiry into financial products and services in Australia*, was the introduction of a statutory fiduciary duty for financial advisers to act in the best interests of their clients. This measure has been supported by government since the initial FOFA reform announcement in April 2010, and is being introduced in the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 as outlined in chapter 2.

Support for a statutory 'best interests' duty for financial advisers

4.2 The evidence received by the committee in its 2009 inquiry highlighted the clear need for a statutory fiduciary obligation for financial advisers to act in the best interest of their clients. This has also been confirmed by evidence presented to the committee during its ongoing inquiry into the collapse of Trio Capital. The committee is currently preparing its report for this inquiry, and the cumulative weight of evidence from the committee's 2009 inquiry, the Trio inquiry and the current inquiry into the FOFA legislation, make an overwhelming case for the introduction of a statutory best interests duty.

4.3 During the current inquiry, the committee received evidence that stakeholders are supportive of the introduction of a statutory duty for advisers to act in the best interests of their clients. The support for this measure included support from industry peak bodies, consumer groups, accounting bodies as well as Treasury and ASIC,[1] and was well summarised by the Joint Accounting Bodies:

> The Joint Accounting Bodies believe the majority of financial planners provide quality financial advice that is in the best interests of the client. However, the introduction of a statutory best interests obligation will embed this motivation in the financial advice framework to ensure all financial planners make certain the interests of their clients remain paramount, above and beyond those of the planner, licensee and any relevant associates. We believe introducing this obligation will improve the public's trust and confidence in the advice they receive.[2]

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1 Association of Financial Advisers Ltd, *Submission 66*, p. 12; Financial Services Council, *Submission 58*, p. 41; Financial Planning Association of Australia, *Submission 62*, p. 16; Joint Accounting Bodies, *Supplementary submission 23*, p. 3; Associate Professor Joanna Bird, *Committee Hansard*, 23 January 2012, p. 57; ASIC, *Supplementary submission 28*, p. 12; Treasury, *Supplementary Submission 22*, p. 3.

2 Joint Accounting Bodies, *Supplementary submission 23*, p. 1.

4.4 The committee heard that many parts of the financial advice industry already adhere to a 'client's best interests' standard of advice. The Association of Financial Advisers (AFA) currently imposes a 'best interests' obligation on its members as part of its code of ethics, and the Financial Planning Association's (FPA) code of practice requires members to place the interests of clients ahead of their own.[3] The Boutique Financial Planning Principals Group (BFPPG) also noted that its members must act in their clients' best interests as a condition of membership.[4]

4.5 While the intent of the best interests provisions was therefore welcomed by the industry, numerous submitters made comment on the precise nature and scope of the duty contained in the Bill. This is discussed further below.

Formulation of the 'best interests' provisions

4.6 The 'best interests' obligation is formulated through several clauses in the second FOFA Bill. The Bill proposes to insert new Division 2 in Part 7.7A of the Corporations Act. This new Division contains all provisions relating to the 'best interests' duty.

4.7 The best interests obligations are divided into several components, including:

- a general duty that advisers must act in the best interest of their clients, supplemented by a series of steps advisers can take in order to meet this duty (subsections 961B(1) and 961B(2));
- a requirement that advice given by providers is appropriate to the client (section 961G); and
- a requirement that if there is a conflict between the interests of the client and those of the provider, licensee or authorised representative, the provider must give priority to the client's interests (section 961J).

4.8 The provisions of subsections 961B(1) and 961B(2), 'provider must act in the best interests of the client' are as follows:

> (1) The provider must act in the best interests of the client in relation to the advice.
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> (2) The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:
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> a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
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> b) identified:

3 Association of Financial Advisers, 'AFA Code of Ethics', http://www.afa.asn.au/members_conduct_ethics.php (accessed 25 January 2012); Mr Mark Rantall, Chief Executive Officer, Financial Planning Association, *Committee Hansard*, 23 January 2012, p. 40.

4 Boutique Financial Planning Principals Group Inc., *Submission 48*, p. 4.

(i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and

(ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the client's relevant circumstances);

c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;

d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;

e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:

(i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and

(ii) assessed the information gathered in the investigation;

f) based all judgements in advising the client on the client's relevant circumstances;

g) taken any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

4.9 Additionally, section 961H provides that if, after 'reasonable inquiries' have been made, information from the client is incomplete or inaccurate, the provider may still give advice, but must warn the client that the advice is based on incomplete or inaccurate information.

4.10 Proposed Subdivision F of Part 7.7A provides for the responsibilities of licensees in relation to the best interests duty. Licensees must ensure that their representatives comply with the best interests provisions, and that licensees which breach the best interests provisions are subject to civil penalties (sections 961K-961N). Subdivision G provides for the responsibilities of authorised representatives. Authorised representatives who contravene the best interests provisions are also subject to civil penalties (section 961Q).

4.11 Subdivision A provides that the best interests obligations apply only in relation to the provision of personal advice to retail clients (subsection 961(1)). This means that advisers providing general advice only will not be subject to the best interests obligations. The subdivision also includes a definition of 'provider' for the purposes of the section; namely, 'the individual who is to provide the advice' (subsection 961(2)).

Replacing current conduct obligations under section 945A and section 945B

4.12 The Bill repeals sections 945A and 945B of the Corporations Act, which deal with conduct obligations for financial advisers. As noted in chapter 1, section 945A of the Corporations Act requires that advisers providing personal advice must have a 'reasonable basis' for that advice, based on the relevant personal circumstances of the client and the adviser having conducted 'reasonable inquiries in relation to those personal circumstances' and the subject of advice. The Explanatory Memorandum (EM) to the Bill states that the requirement for advice to be appropriate to the client is retained in the new section 961G, and that the process-related elements involved in this requirement have been incorporated into the steps of the new best interests obligations found in subsection 961B(2).[5]

4.13 Additionally, the EM notes that section 961H, relating to providing advice in the event of incomplete or inaccurate information, is a replacement of similar provisions in section 945B.[6]

Views of submitters on the 'best interests' provisions in section 961B

4.14 Many submitters commented on the drafting and potential effect of the best interests provisions in section 961B. The issues raised included:

- whether or not the best interests provisions amount to a statutory fiduciary duty for advisers, as recommended by this committee's 2009 report;
- whether the 'reasonable steps' provisions in subsection 961B(2), particularly the inclusion of paragraph 961B(2)(g), make the duty unclear and unworkable for advisers to implement; and
- whether the best interests obligations will adequately facilitate the provision of limited or 'scaled' advice.

Fiduciary duty provisions

4.15 The committee's 2009 report on financial products and services in Australia recommended that the Corporations Act be amended to explicitly include a fiduciary duty for financial advisers operating under an Australian Financial Services License, requiring them to place their clients' interests ahead of their own.[7] The best interests provisions in the Bill are intended to directly implement this recommendation.[8]

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5 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 16–17.

6 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 17–18.

7 Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, November 2009, p. 110.

8 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 6.

4.16 According to the EM, the Bill has taken the approach of setting out a general duty for advisers to act in the best interests of their clients, while also setting out a number of reasonable steps that may be taken as complying with that duty.[9] Some submitters argued, however, that this approach falls short of placing a fiduciary duty on advisers. For example, the Trust Company asserted that a best interest duty as provided for in the Bill:

> ...is not a complete fiduciary obligation but one aspect of it. A fiduciary obligation is a principle based on undivided loyalty and trust to act in good faith and in the best interests of a client. Looked at in isolation a best interest obligation is not as far reaching.[10]

4.17 Furthermore, the Trust Company submission argued that the prescriptive duty encompassed in subsection 961B(2) constitutes a duty of care rather than an explicit fiduciary duty:

> A duty of care is a requirement to meet a standard of reasonable care and skill when performing a service or providing a product. The standard is objective and based on what is expected of the "reasonable" person, service provider or manufacturer. A person can owe another person a duty of care without being subject to a duty of loyalty.
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> ...
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> The best interest duty as expressed in the Bill is a prescriptive duty and will cause confusion and uncertainty in the industry. It is confusing a duty of care on one hand with a duty of loyalty on the other. The Bill attempts to address a duty of loyalty by using standards and rules which are associated with the duty of care. These two duties cannot be confused. It is the duty of loyalty that underpins the fiduciary obligation and it is this duty that should be met.[11]

4.18 The Law Council of Australia agreed with this sentiment, stating that the steps in subsection 961B(2) 'strongly imply that an adviser's best interest duty under 961B has been mislabelled and is more akin to the adviser's duty of care at general law rather than their fiduciary duties'.[12]

4.19 The Industry Super Network (ISN) also commented on this issue, noting that the process steps outlined in subsection 961B(2) are atypical in a fiduciary-type duty and more similar to a duty of care.[13] ISN advocated that the drafting of the best interests duty should be 'along more traditional lines, which would have left it as the

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9 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 6.

10 The Trust Company, *Submission 53*, p. 11.

11 The Trust Company, *Submission 53*, pp 2, 7.

12 Law Council of Australia, *Submission 55*, p. 3.

13 Industry Super Network, *Supplementary submission 12*, p. 2.

principles-based duty contained in s961B(1)'.[14] The Australian Institute of Superannuation Trustees agreed that a broad, principles-based fiduciary duty would have been preferable to the prescriptive duty contained in the Bill.[15]

4.20 The Joint Consumer Groups commented that the description of section 961B as a best interests duty, when it is really a duty to exercise reasonable care and diligence, may cause uncertainty and unpredictability. It stated:

> ...it may be difficult for courts and external dispute resolution schemes to interpret the duty and there is a risk that their interpretations may not further the government's policy aim.[16]

'Reasonable steps' provisions of subsection 961B(2)

4.21 As outlined above, some stakeholders queried why the best interests duty has been formulated with both a general duty in subsection 961B(1) and the 'reasonable steps' provisions contained in paragraphs 961B(2)(a)-(g), rather than a more general best interests duty similar to that contained in the *Superannuation Supervision Act 1993* (SIS Act).[17] The EM to the Bill provides a rationale for this formulation. With regards to the process steps in subsection 961B(2), the EM states:

> These steps have been set out based on the specific conditions under which advisers currently operate. This approach is needed given the broad nature of a best interests obligation; it may allow a provider to demonstrate that it has complied with the obligation by providing it took certain steps.[18]

4.22 While the intent to provide a 'safe harbour' to help advisers discharge their duty was welcomed, some stakeholders expressed concern about the specific wording of the provisions contained in subsection 961B(2). For example, the Financial Services Council (FSC) expressed concern that the provisions in subsection 961B(2) are drafted in a way which places an unreasonable burden of proof on the adviser to prove that they have acted in the client's best interest. The FSC suggested that the provisions be drawn conversely, allowing an adviser to refute specific allegations that they have not acted in the client's best interest.[19]

4.23 In particular, the inclusion of paragraph 961B(2)(g) provoked much commentary from stakeholders. Paragraph 961B(2)(g) provides that having taken the steps outlined in 961B(2)(a)-(f), a provider must also have 'taken any other step that

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14 Industry Super Network, *Submission 12*, p. 2.

15 Australian Institute of Superannuation Trustees, *Supplementary Submission 18*, p. 3.

16 Joint Consumer Submission, *Submission 25*, p. 11.

17 Section 52 of the SIS Act includes a statutory obligation for superannuation trustees to act in the best interest of fund members (see also paragraph 4.32 below).

18 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 9.

19 Financial Services Council, *Submission 58*, pp 43, 47–48.

would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances' in order to satisfy the best interests duty. Several stakeholders expressed concerns that this paragraph adds uncertainty for advisers trying to fulfil their best interests obligations, and that as a result, the reasonable steps provisions fall short of providing the 'safe harbour' envisaged in the government's initial policy announcements.[20] The Law Council of Australia argued:

> Although section 961B(2) provides that a provider will be deemed to comply with their statutory best interests duty if they prove that they have satisfied all of the steps in section 961B(2), section 961B(2)(g) effectively takes away the certainty the opening words offer...In other words, a provider will comply with their statutory duty to act in the best interests of their client if they prove that they have acted in the best interest of their client. The statutory defence in section 961B(2) therefore gives providers no comfort at all that if they follow the prescribed steps they will have discharged their obligation and leaves them with the difficult task of determining what the statutory duty to act in the best interests of their client means.[21]

4.24 Several stakeholders advocated the removal of paragraph 961B(2)(g) so as to achieve greater certainty regarding the operation of the proposed best interests duty.[22] AMP suggested that if paragraph (g) is not removed, that it should be amended to reflect the fact that the obligation is designed to be imposed at the time that advice is provided.[23]

4.25 Conversely, ISN expressed concern that the inclusion of reasonable steps provisions hinder the goal of raising standards in the industry, noting 'there is a significant risk that defining a professional duty through process will result in a "tick-a-box" mentality rather than shifting financial planning to a more professional culture'.[24]

4.26 Treasury officials indicated that the inclusion of paragraph 961B(2)(g) is designed to help avoid a "tick-a-box" attitude, and that paragraph (g) was not designed to be overly burdensome for advisers:

> In terms of interpretation, the problem we have ... is that if you take out (g) you are virtually going back to a tick a box type arrangement. With (g) it is taking any other step, so the provider satisfies the duty and take any other step that would reasonably be regarded as being in the best interest of the

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20 AMP Financial Services, *Submission 43*, p. 16; Mr Paul Barrett, General Manager, Advice and Distribution, ANZ Wealth, *Committee Hansard*, 24 January 2012, p. 4; Associated Advisory Practices, *Supplementary Submission 20*, p. 6.

21 Law Council of Australia, *Submission 55*, p. 4.

22 Financial Services Council, *Committee Hansard*, 23 January 2012, pp 33–34; AMP Financial Services, *Submission 43*, p. 16; Law Council of Australia, *Submission 55*, p. 4.

23 AMP Financial Services, *Submission 43*, pp 16–17.

24 Industry Super Network, *Submission 12*, p. 2.

> client given the client's relevant circumstances. So it is any other step reasonably regarded.
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> ...
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> Where the companies are worried, they say, 'We go through all these steps and then we give good advice, something does not work out and then we get sued over this.' I would have thought 'reasonably regarded as in the best given the client's relevant circumstances' pretty much does it.[25]

4.27 ASIC noted that other 'safe harbour' provisions in the Corporations Act are more rigorous than a "tick-a-box" approach, and achieve an increase in professionalism:

> ...I am aware from reading the submissions that there has been differing views on whether the last paragraph of that particular provision, paragraph (g), is appropriate or not and I think there is clearly a policy decision to be made about whether or not there is to be a tick-a-box approach in terms of how this defence is going to work or there is going to be something more substantive. I can only point to other provisions in the Corporations Act. For example, there is a safe harbour provision for directors' duties provisions and it is certainly not a tick-a-box approach. It requires people to assess things like they have made a judgment in good faith and for a proper purpose, they do not have a material personal interest, they have informed themselves about the subject matter of the judgment and they rationally believe the judgment is in the best interests of the corporation.[26]

4.28 ASIC also commented that it believed the safe harbour provisions are adequate and that they meet the policy objective:

> I think the question is: what policy result do you want to achieve? That is really a matter for government. The stark choice I am drawing is whether or not you want a tick-a-box approach, which you really get very close to if the provision in (g) is removed, or whether you want to transform this into a profession and have people exercising particular judgment in particular cases as other professionals do.[27]

4.29 ASIC also noted that paragraph 961B(2)(g) adds flexibility to the reasonable steps provisions that may be useful in administering the legislation:

> I might just add that there is a balance to be struck in any of these types of provisions between providing people with certainty but also providing some flexibility about how things are administered. If you were to remove (g), you would remove effectively the flexibility. My experience with these

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25 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, p. 64.

26 Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, pp 69–70.

27 Mr John Price, Senior Executive Leader, Strategy and Policy, ASIC, *Committee Hansard*, 24 January 2012, pp 69–70.

> sorts of reforms is that often industry actually wants both—they want some certainty but also some flexibility. That is I think an appropriate way to approach that. As Mr Price has indicated, this sort of approach, where you have a list of particular issues that must be dealt with plus a provision that allows for other matters that might arise from time to time or might be considered, is not unusual in other parts of the law that ASIC itself administers. We have some experience with these sorts of issues.[28]

Interaction with other general law and statutory duties

4.30 The Law Council of Australia expressed concern that the formulation of the best interests duty in subsection 961B(1) does not accord with either the general law fiduciary duty to act in the best interests of their client, or other existing statutory best interests duties; namely, those for superannuation trustees and for the responsible entities and directors of managed investment schemes.[29]

4.31 The Financial Services Council noted that new best interests obligations on advisers would add to, rather than replace, existing duties for advisers:

> ...whilst the steps in s961B(2) are largely congruent with, they are **additional** to the duty an adviser owes their client under common law fiduciary obligations (profit and conflict rules) and at contract law (and torts). As such advisers will operate under a number of, each slightly nuanced, disparate legal 'best interest' obligations which adds to the complexity and cost of the regime.[30]

4.32 Westpac Group argued that to avoid advisers being subject to both general law duties and the new statutory duty, the legislation should make it clear that compliance with the best interests obligation will be deemed compliance with the general law obligations.[31]

4.33 The Law Council of Australia noted that in addition to general law duties, superannuation trustees providing personal advice are subject to obligations under the SIS Act which obligates trustees to perform their duties in the best interests of members.[32] The Law Council contended that there may be situations where the new best interests duty under section 961B conflicts with trustees' existing duty under the SIS Act; the SIS Act requires trustees to act in the best interests of fund members as a whole, whereas the new duty requires trustees to act in the best interests of the individual member being provided advice. For example, if personal advice was given

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28 Mr Peter Kell, Commissioner, ASIC, *Committee Hansard*, 24 January 2012, p. 70.

29 Law Council of Australia, *Submission 55*, p. 3.

30 Financial Services Council, *Submission 58*, p. 42.

31 Westpac Group, *Submission 64*, p. 13.

32 Law Council of Australia, *Submission 55*, pp 4–5. The existing best interest obligations for superannuation trustees are contained in *Superannuation Supervision Act 1993*, paragraph 52(2)(c).

that a member should switch out of the superannuation fund (with the adviser having deemed that this is in the client's best interest), the result of this advice may be detrimental to fund members as a whole due to reduced economies of scale. [33]

Regulations may alter the best interests obligations

4.34 Subsection 961B(5) of the Bill provides that regulations may be made to add or substitute steps to those outlined in subsection 961B(2) in prescribed circumstances. The regulations may also outline that certain steps in subsection 961B(2) do not apply to providers in certain circumstances, or outline circumstances in which the general duty in subsection 961B(1) does not apply. The EM explains the rationale for including these provisions in the Bill as follows:

> It is important for there to be a degree of flexibility around the more detailed aspects of the best interests obligation because of the diversity and complexity of the financial services industry.
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> This regulation-making power will allow the legislation to be updated in a timely manner in the event that the application of a particular step (or steps) is found to result in undesirable consequences in the light of advancements in the financial services industry or the provision of advice in unique and unforseen circumstances.[34]

4.35 The Senate Standing Committee for the Scrutiny of Bills noted in its *Alert Digest No.1 of 2012* that these provisions allow the central elements of a statutory obligation to be dealt with by regulations rather than primary legislation, and suggested that the Senate consider whether this delegation of legislative power is appropriate.[35]

Concerns about increasing professional indemnity insurance premiums

4.36 Professional Investment Services claimed that the increased obligations on advisers under the new best interests provisions will increase the cost of advisers obtaining professional indemnity insurance, a cost which would be ultimately borne by consumers.[36] The Financial Services Council agreed, warning:

> Without a defined duty and non-exhaustive conduct steps, Professional Indemnity ("PI") insurers will become cautious for years (whilst the new duty is tested in the courts) during which time – costs of PI cover will

33 Law Council of Australia, *Submission 55*, p. 5.

34 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 16.

35 Senate Standing Committee for the Scrutiny of Bills, *Alert Digest No. 1 of 2012*, 8 February 2012, pp 7–8.

36 Professional Investment Services, *Supplementary submission 17*, p. 7.

> remain high (higher than current costs) thereby increasing the cost of advice for Australians without any commensurate consumer protection.[37]

Ability for advisers to provide scaled advice under the new duty

4.37 One of the stated aims of the FOFA reform package is to increase the availability of limited or 'scaled' financial advice to consumers. Scaled advice is currently permissible under section 945A of the Corporations Act. The stated intention of the new best interests obligations is to continue and expand access to scaled advice. As explained by Treasury:

> The steps [in subsection 961B(2)] are designed to facilitate the provision of 'scaled advice' which is advice about one issue, or a limited range of issues (as opposed to 'holistic' advice that looks at all aspects of the client's financial circumstances). As long as the provider acts reasonably and bases the decision to narrow the subject matter of the advice on the interests of the client, they will not be in breach of their obligation to act in the client's best interests.[38]

4.38 The government has expressed a clear commitment to facilitating the provision of scaled advice, and particularly limited advice provided by superannuation funds to their members. This is known as 'intra-fund' advice. Announcing new rules for the provision of intra-fund advice in December 2011, the Minister for Financial Services and Superannuation, the Hon Bill Shorten MP, stated:

> The delivery of scaled advice is critical to achieving the Government's objectives of promoting greater access to financial advice. This Government is committed to providing advisers with certainty of how to provide this form of advice in a way that meets their regulatory obligations.[39]

4.39 The provision of intra-fund advice by superannuation funds is currently allowed under an ASIC Class Order, which exempts funds providing intra-fund advice from any requirements in section 945A of the Corporations Act. [40] This Class Order is supplemented by an ASIC Regulatory Guide which provides further guidance about how trustees can provide intra-fund advice.[41]

4.40 Despite the clear policy intent to facilitate access to scaled advice, some submitters to this inquiry contended that the current drafting of the best interest provisions does not provide comfort for financial advisers seeking to provide scaled

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37 Financial Services Council, *Submission 58*, p. 41.

38 Treasury, *Supplementary submission 22*, p. 4.

39 The Hon Bill Shorten MP, Minister for Financial Services and Superannuation, 'Improving access to simple financial advice', *Media Release No. 164*, 8 December 2011.

40 ASIC Class Order CO 09/210, *Intra-fund superannuation advice*, July 2009.

41 ASIC Regulatory Guide 200, *Advice to super fund members*, July 2009.

advice.[42] In order for scaled advice to occur, advisers must be able to effectively limit the scope of the advice provided to a client while still fulfilling their obligation to act in the client's best interests. However, the committee heard that current drafting of the 'reasonable steps' provisions in subsection 961B(2) may not allow advisers to do this. In particular, paragraph 961B(2)(b) requires providers to identify:

> (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
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> (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the ***client's relevant circumstances***).

4.41 The EM notes that identifying the subject matter of advice sought could be a simple process, but that:

> [1.33] in some cases, particularly where the client has complex needs or objectives, it is recognised that clients may not be immediately able to identify the subject matter of the advice they are seeking. In these situations, it may be necessary for the provider to enter into a discussion with the client about what subject matter of advice would be in their best interests. This can take into account considerations like how much the client is willing to spend on the advice. However, the provider cannot enter into a contract to be exempted from this obligation merely by seeking formal agreement from the client that the subject matter of the advice that has been given by the provider is what has been requested by the client and is therefore in the client's best interests. In identifying the advice that has in effect been sought by the client (including advice implicitly sought by the client), the provider must take into account the client's overall circumstances.[43]

4.42 The EM further states that this process of identifying the subject matter of advice can still facilitate the scaling of advice:

> [1.34] This process is designed to accommodate the provision of limited advice (also referred to as 'scaled advice') that only looks at a specific issue (for example, single issue advice on retirement planning) and 'holistic' advice that looks at all the financial circumstances of the client...As long as the provider acts reasonably in this process and bases the decision to narrow the subject matter of the advice on the interests of the client, the provider will not be in breach of their obligation to act in the client's best interests. The scaling of advice by the provider must itself be in the client's best

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42 Association of Financial Advisers Ltd, *Submission 66*, p. 12; Association of Superannuation Funds of Australia, *Supplementary Submission 1*, pp 2–4; AMP Financial Services, *Submission 43*, p. 17; Westpac Group, *Submission 64*, p. 15; Professional Investment Services, *Supplementary submission 17*, pp 5–6.

43 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, pp 11–12.

> interests, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances.[44]

4.43 Submitters pointed to differences in expressions used in the Bill and EM; subparagraph 961B(2)(b)(ii) refers to the client's *relevant* circumstances, while the EM claims that advisers must take into account the client's *overall* circumstances when determining the subject matter of advice. AMP Financial Services stated with regards to their ability to provide scaled advice:

> In our interpretation of the bill at present it would be very difficult for us to do so because of the point I alluded to earlier that, in the way that the bill is currently drafted, we would be required to consider the client's whole financial position, even if the client came in saying they only wanted to consider one component of their finances.[45]

4.44 Several submitters argued that the wording in subsection 961B(2) should be amended to explicitly allow the provision of scaled advice.[46] The FSC argued that the ability to scale advice should be clearly expressed in the legislation to provide additional clarity:

> Clear express statutory recognition of the ability to scale or scope the advice subject matter is what enables an adviser to focus their advice investigation to the area(s) the client has identified, instructed or agreed they want the advice to address and therefore curtail the cost of providing the advice...Further amendment is required to s961B(2) to expressly provide the ability to scale advice.[47]

4.45 The ISN offered an alternative view, arguing that there is no issue with the provision of scaled advice under the best interests obligations imposed by the Bill:

> There is nothing in the best interests duty as drafted within s961B which is inconsistent with the delivery of scaled or limited scope financial advice. Industry super funds, who have been market leaders in terms of rolling out limited scope financial advice services to members on their superannuation, are supportive of this duty.[48]

4.46 AustralianSuper agreed with this position, stating that the best interests duty is compatible with the provision of scaled advice and intra-fund advice in its current

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44 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 12.

45 Mr Craig Meller, Managing Director, AMP Financial Services, *Committee Hansard*, 23 January 2012, p. 4.

46 Financial Services Council, *Submission 58*, p. 46; Australian Bankers' Association, *Submission 67*, p. 17.

47 Financial Services Council, *Submission 68*, pp 45–46.

48 Industry Super Network, *Supplementary Submission 121*, p. 2.

form, and strikes the appropriate balance between protecting consumers and providing clarity to advisers by providing steps to demonstrate compliance.[49]

4.47 Treasury officials explained that the intent of the wording in the legislation and EM was to help facilitate scaled advice while protecting consumers, and emphasised that only relevant investigations would need to be made by advisers when scaling advice. Treasury commented that the policy intention is to allow clients and advisers to agree to the scope of advice:

> ...This is scaled advice. They should be able to work out scaled advice, but I will give you an example which I put to AMP. If a person walked through the door and said that they wanted some financial advice on how to do some margin lending or get some contracts for difference, there must be an obligation on a financial adviser not to just say, 'Okay—hand us over the money, and we'll organise it for you.' The idea of the way that the legislation and the explanatory memorandum are set out is that the financial service provider would make enough inquiries to decide whether that was suitable or not.[50]

4.48 In commentary on the use of the term 'overall' in the EM, Treasury stated:

> ...I would read 'overall' down to say that if a person—say it was someone around this table—walked into a financial adviser and wanted to do margin lending, some enquiries would have to be made—.[51]

4.49 However, in response to committee questioning, Treasury commented that it would be helpful to clarify in the EM that it is 'relevant' rather than 'overall'.[52]

4.50 Additionally, ASIC made it clear that it intends to provide regulatory guidance to assist advisers in providing scaled advice in a manner which is consistent with their best interests obligations. ASIC noted that it has already provided guidance on scaling advice through several regulatory guides[53] and a July 2011 Consultation Paper *Additional guidance on how to scale advice* (CP 164). ASIC will finalise its guidance on scaling advice in 2012, taking into account the best interests duty proposed in the Bill:

> Once the new obligations are in place, ASIC will continue to provide guidance with the aim of increasing access to advice by facilitating industry

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49 AustralianSuper, *Submission 38*, p. 2.

50 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

51 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

52 Mr Jim Murphy, Executive Director, Markets Group, Treasury, *Committee Hansard*, 24 January 2012, pp 63–64.

53 Namely Regulatory Guide 200, *Access to advice for super fund members*; Regulatory Guide 84, *Super switching advice: Questions and answers*; and Regulatory Guide 175, *Licensing: Financial product advisers—Conduct and disclosure*.

> to provide scaled advice while complying with the relevant advice obligations (as we have in the past with RG 200 and CP 164). This guidance will discuss a range of topics, including how the fact find process in giving advice can be either limited or expanded, depending on the complexity of the advice being provided.[54]

Use of computer programs to deliver scaled advice

4.51 The EM to the Bill notes that the 'best interests' provisions are designed to take into account the fact that computer programs are increasingly being used to provide advice to clients.[55] The Bill attempts to facilitate this when defining the 'provider' of advice by including subsection 961(6), which provides:

> A person who offers personal advice through a computer program is taken to be the person who is to provide the advice, and is the ***provider*** for the purposes of this Division.

4.52 Several submitters questioned the intent of this provision, noting that the provision of scaled advice by electronic facilities may make advice accessible to individuals who otherwise may not access it.[56] Despite the intent in subsection 961(6) to allow advisers to use computer programs to give advice, the FSC commented that there is no clear guidance on how a provider might give advice through a computer system and satisfy the best interests obligations in section 961B. Some of the potential issues raised by the FSC include that computer programs:

- cannot comply with a broad undefined duty to act in the best interests of clients;
- must be able to determine the scope of advice offered, which is not possible under the best interests obligations as drafted, which only allow the client to scale the advice sought;
- are unlikely to be able to determine whether any information entered by a client is inaccurate;
- will not always be able to determine whether it is reasonable to consider recommending a financial product, or how broad a range of products the computer program needs to consider to satisfy the best interests obligation; and
- cannot take any other step that would reasonably be regarded as being in the best interests of the client, as required by paragraph 961B(2)(g).[57]

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54 ASIC, *Supplementary submission 28*, pp 11, 12.

55 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 9.

56 Financial Services Council, *Submission 58*, p. 49; Australian Institute of Superannuation Trustees, *Supplementary submission 18*, p. 2; Australian Bankers' Association, *Submission 67*, p. 18.

57 Financial Services Council Ltd, *Submission 58*, pp 49–50.

4.53 Further clarification may be required either in legislation or regulations to explain how the provision of scaled advice through computer programs or other electronic facilities can be undertaken in the context of the best interests obligations in section 961B.

Scope of the best interests duty and proposed carve-outs

4.54 The Bill proposes limited carve-outs from the best interests obligations for the provision of basic banking products and general insurance products.

4.55 Subsection 961B(3) provides that employees of an Australian Authorised Deposit-taking Institution (ADI) offering advice relating to basic banking products need to satisfy only the steps in paragraphs 961B(2)(a)-(c) in order to satisfy their best interests obligation. Similarly, subsection 961B(4) states that if the subject matter of advice sought by a client is solely a general insurance product, a provider needs to only take the steps in paragraphs 961B(2)(a)-(c) to fulfil their obligation.

4.56 Under subsections 961J(2) and 961J(3), advice provided on basic banking products and general insurance products is also exempted from the requirement in subsection 961J(1) that a provider must give priority to the client's interests in the event of any conflict of interest.

4.57 The EM explains the rationale behind the provision of this limited carve-out from the best interests obligations:

> Basic banking products and general insurance are recognised as being simple in nature and are more widely understood by consumers. This means that there is a lower risk of consumer detriment in relation to the provision of advice on these products. For this reason, a modified best interests obligation more appropriately balances the benefits to consumers with the compliance costs to providers.[58]

4.58 Treasury explained to the committee why the limited carve-out approach had been adopted in relation to basic banking advice. It noted that some of the provisions relating to the appropriateness of advice in section 945A, which currently must be adhered to by banks, had effectively been transferred across to the new provisions in paragraphs 961B(2)(a)-(c):

> What we have done with the legislation, banks are currently subject to section 945A in the Corporations Act and that has a number of steps that have to be taken and a requirement that the advice be appropriate. That currently applies to the banking sector. With the revised best interest duty, we have taken some of the process steps out of 945A and included them in the new best interest duty and we also have the appropriate advice provision in the new bill. What we have done is say that those steps that the banks used to be subject to under 945A they will continue to be subject to in the

58 Explanatory Memorandum, Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011, p. 16.

> new legislation and they will also be subject to the appropriate advice test in the new legislation.[59]

4.59 Treasury concluded that 'the intention is to reflect as far as possible the banks' current position' that is, business as usual in relation to basic banking.[60]

4.60 The Insurance Council of Australia welcomed the limited carve-outs applied to basic banking and general insurance products, and agreed with Treasury that the applicable provisions in paragraphs 961B(2)(a)-(c) largely reflect the current requirements under section 945 of the Act.[61]

Advice relating to basic banking products

4.61 Stakeholders from the banking industry disagreed with Treasury's assessment of the situation for basic banking products. The Australian Bankers' Association (ABA) expressed concern that the elements contained in paragraphs 961B(2)(a)-(c), which will still apply to basic banking products, could significantly extend the obligations for bank staff and bank specialists, and even lead to banks declining to provide personal advice:

> As currently drafted, the carve out from the best interests duty is unclear and not absolute, and therefore will create additional regulation, which will likely make it too difficult and too costly for some banks to continue to provide advice on basic banking products.[62]

4.62 The ABA noted that banks currently pursue a variety of models for providing financial advice, based on the differences between how factual information, general advice and personal financial advice are regulated.[63] As the new best interests obligations only apply to the provision of personal advice, the ABA argued that some banks may adopt a 'no advice' model in order to avoid the legal and compliance uncertainties associated with offering personal advice under the FOFA reforms,[64] with the effect of decreasing access to advice for consumers.

4.63 Abacus, the peak body for Mutuals in Australia, advocated for a 'clear and unambiguous carve-out from the best interests duty for advisers on basic banking products'.[65] Both Abacus and the ABA suggested that section 945A be retained in the

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59 Ms Sue Vroombout, General Manager, Retail Investor Division, Treasury, *Committee Hansard*, 24 January 2012, p .65.

60 Ms Sue Vroombout, Treasury, General Manager, Retail Investor Division, *Committee Hansard*, 24 January 2012, p. 65.

61 Insurance Council of Australia, *Supplementary Submission 39*, p. 3.

62 Australian Bankers' Association, *Supplementary Submission 67*, p. 4.

63 Ms Diane Tate, Policy Director, Australian Bankers' Association *Committee Hansard*, 23 January 2012, p. 22.

64 Australian Bankers Association, *Supplementary Submission 67*, p. 4.

65 Abacus Australian Mutuals, S*upplementary Submission 141*, p.5.

legislation for basic banking products, allowing for a fuller exemption from the new best interests requirements for these products.[66]

Opposition to the proposed carve-outs

4.64 Some stakeholders opposed the inclusion of carve-outs for basic banking and general insurance products altogether. The Joint Consumer Groups rejected the notion that basic banking products and general insurance are simple and well-understood by consumers, claiming that 'basic banking products and general insurance products are still capable of being mis-sold, especially by advisers with incentives to mis-sell, and poor quality advice in relation to these products can still lead to consumer detriment'.[67] They also claimed that the requirement for advisers to consider and investigate the subject matter of the advice, which is part of the current legal obligations under section 945, is not incorporated into paragraphs 961B(2)(a)-(c). The consumer groups asserted that this will result in 'a lowering of the standard of advice in relation to financial products that can be considered essential and, in fact, almost mandatory for the average consumer'.[68]

4.65 The Trust Company argued that the exemptions for basic banking products and general insurance products, on the basis that these products are more simplistic in nature, are inconsistent with the goal of raising the standard and professionalism of financial advice across the industry.[69]

Committee view

4.66 The committee considers that the introduction of a statutory best interests duty for financial advisers to act in the best interests of their clients is a vital reform for the financial advice industry. This duty will help increase the professionalism of the industry and provide additional protection for consumers.

4.67 The committee believes that the formulation of the best interests obligation in the Bill strikes an adequate balance between providing certainty for the industry while ensuring professional standards are raised. The committee notes the concern expressed by some stakeholders regarding the inclusion of paragraph 961B(2)(g), but believes this paragraph is necessary to achieve the objective of increasing professionalism in the industry.

4.68 The committee commends the Bill for promoting the provision of scaled advice. For added clarity, the committee believes that paragraph 1.33 of the EM should be redrafted to refer to the client's *relevant* circumstances rather than the

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66 Abacus Australian Mutuals, S*upplementary Submission 141*, p.5; Australian Bankers' Association, *Submission 67*, p. 12.

67 Joint Consumer Submission, *Supplementary Submission 25*, pp 5–6.

68 Joint Consumer Submission, *Supplementary Submission 25*, pp 4–5.

69 The Trust Company, *Submission 53*, pp 7, 9.

client's *overall* circumstances. The committee considers that this change, along with additional regulatory guidance from ASIC, will allay industry concerns about the ability for advisers to offer scaled advice.

4.69 The committee considers that the limited carve-outs from the best interests obligations for basic banking and general insurance products are warranted and will facilitate the provision of advice relating to these products to consumers.

Recommendation 4

4.70 The committee recommends a revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 be issued such that the final sentence in paragraph 1.33 of the Explanatory Memorandum reads:

> **'In identifying the advice that has in effect been sought by the client (including advice implicitly sought by the client), the provider must take into account the client's relevant circumstances.'**