

BFPPG Assessments of October Release of FSR Refinements material from Treasury.

DRAFT

19 December 2005

Overview:

This is our assessment of FSR Refinements as released in October. *From our understanding so far, seems to be a remarkably big step towards a good outcome. Congratulations Treasury.*

However, we do note that there still may be issues we have not come to recognise yet (remember how long it took us to get everyone to recognise the problems in FSR Version 1).

Details & discussion:

In the discussion below, we have assessed the October FSR refinements against the list of issue we have raised:

- 1. For regular and ongoing advice, can we have all the advice judged in totality?** Yes, David Love confirmed that in an email dated 20/10/05. Previous to that ASIC's policy unit had been trying to ensure that our advice followed a certain FORM and that certain sub-sets of advice were required to be judged for compliance in isolation of all other advice - a position many regular-and-ongoing advice providers found excessively arbitrary, unworkable and adding considerably to the cost to the consumer. In summary:
 - ⇒ Regular-and-ongoing advice can be judged in totality.
 - ⇒ FSR Refinements are a **victory of substance over form.**
 - ⇒ That is to say the focus has shifted the emphasis on consumer protection back much more onto:
 - the common law requirements re negligence, misleading and deceptive conduct, due care.
 - FSRA requirement that there was a reasonable basis for the advice AND the advice was reasonable in the circumstances. S945A.
 - FSRA requirement that SoA was "clear, concise and effective" s947B(6)
 - FSRA requirement "do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" s912A(1)(a).
 - The ASIC Act 2001
 - Misleading or deceptive conduct. Section 12DA.
 - False or misleading representations. Section 12DB.
 - Requirements to apply due care and skill, and that advice is fit for the purpose. Section 12ED.
 - PLUS disclosure of commissions and information that might influence the advice, as required under FSRA - helping consumers make informed decisions & helping consumers recognise conflicted advice.

These are big steps forward for all regular-and-ongoing advice providers - and their clients.
- 2. Disclosure.** The focus remains on disclosure of all factors which might influence - eg commission + relationships. This was the dominant new development in FSR. It remains completely in tact and we believe it should. This is good. No problems there. Being able to disclose trails in percentage terms has been important - and also that an SoA only has to disclose commissions and not fund manager fees (which are in the PDS) has also been important.
- 3. What is the level of detail required for basis for investment advice?** This was a tough one. How do you make this requirement workable without removing it altogether? This was not easy.. This is why we were an advocate for the view that this requirement was "nice in principle, unworkable in practice - except for simple and simplistic advice." ASIC seems to have solved that problem unofficially. The Sample SoA provided a basis for advice which is far from the letter of the law. Given the current law , it

is easy to see how the ASIC Sample SoA would be judged as non-compliant (and possibly negligent) on this test alone. As we see it, ASIC has in effect made this requirement fairly meaningless ... it seems that if you provided any semblance of "basis for advice" regardless of how flimsy that would do. In summary:

⇒ Problem seems to be largely solved.

⇒ However, clearly there is plenty of ground for argument on this issue.

⇒ So the issue does remain grey - which is unfortunate from a business risk perspective. Which means that many advisors will probably continue to provide excessive material to clients to cover their perceived business risks (increasing costs to clients)

⇒ Then there is FICS ... God knows how FICS will deal with this issue.

4. **Materiality.** This one seems largely solved by the refinements - particularly for independent, pure-fee-for-service advisors where there is no commission on each new transaction. To assist this, our understanding is that it is up to the advisor to determine whether :

⇒ The basis for the advice has not significantly changed. Refinements draft regs Section 7.7.10AJ(2)(c)

⇒ The clients personal circumstances are not significantly different from when previous advice was provided. Refinements draft regs Section 7.7.10AJ(2)(b)

5. **Civil liability.** This had been a major concern. David Love pointed out he believed we were covered under a common law issue where under civil liability, there had to be a connection between a defect and a loss. Mind you, FICS remains a wild-card on this topic as usual.

6. **Statements of Advice.** We believe that FSRA refinements have largely (maybe even totally) solved this problem. The key element is that regular-and-ongoing advice providers are allowed to put a preface at the top of all new advice documents saying something along these lines:-

Statement of Advice (SOA).

This Statement of Advice must be seen as part of the set of advice provided to you over time (including all previous Statements of Advice and any advice provided by XYZ Financial Advice Pty Ltd under pre-Australian Financial Services Licences) and does not stand separate from previous advice. Therefore you must regard all previous Statements of Advice as being included in this Statement of Advice except to the extent that later advice supersedes previous advice. Part of the basis for my advice may also be found in newsletters and papers that I have prepared and circulated.

David Love (Treasury) confirmed that this was OK on 20/10/05. **A big thank you to David.**

7. **Statements of Additional Advice are dead.** They were never the solution. There has been no announcement to this effect - but after FSRA refinements, why would you bother.

8. **General Statements of Advice.**

General advice is general communication between an advisor and his ongoing clients where the advisor provides a recommendation to a set of clients that would for example, hold regardless of the client's circumstances – or where the advisor knew this this communication was relevant for this sub-set of clients.

Observation: Advisors are only going to be giving this form of advice to clients to whom the advisor has given an SoA to before and where the advisor has an ongoing advice relationship with the client. We would expect and hope that the advisor has for his own protection, had the client has sign an advisory agreement which defines the client's responsibilities and the rules that govern the relationship between the advisor and the client. Otherwise such advice might be seen to be a little reckless - from at least a business risk perspective.

This being the case, if an advisor provided general advice, what are the advisor's compliance obligations under FSR Refinements as released in October 2005? Obligations would seem to be:

- 1 **A record of advice** – Many advisors would only provide this type of advice in written form eg by email or circular to clients. In such cases it would be desirable (and perhaps expected) that the advisor maintain records as to whom such general advice has been sent to. The general advice circular might be prefaced with the FSR V1 general advice warning - which perhaps

could be watered down under FSR Refinements. This seems to satisfy the requirements of a **Record of Advice**.

However, Under FSRA refinements to comply with RoA requirements more tightly (reduce business risk) maybe this general advice should have a qualifier that this general advice needs to be seen in the context of all other specific personal advice provided the client. (Ref: Section 2.1 of explanatory memorandum on FSR refinements release in October 2005 - Page 6).

- 2 **If there are "factors that might (be seen to) influence", then this has to be disclosed in writing to the client.** (Ref draft regulations circulated by Treasury in October - Section 7.7.10AJ(3)). This disclosure is a document that contains any financial benefit the advisor might receive for giving the advice AND any other factors which might influence eg the advisor recommended an investment from a product provider who owns 33% of the advisor's business entity.) However, for many independently-owned AFS licencees, there is nothing to disclose on either score, in which case we would believe that we do not need to provide an additional disclosure or disclosure document.

Bottom line: IFSR Refinements have solved this problem along with most other concerns we have raised.

9. Obligation to provide an SoA "every time an advisor could reasonably be regarded as seeking to influence a retail consumer regarding a financial product or class of product."

This was a huge one because it meant that anyone who was not providing anything but the simplest advice, almost certainly broken the letter of the law on a regular basis. Now, under the FSR refinements, where an ongoing relationship exists, this problem has gone a way we believe - with the possible exception:

→ of where some advisors give **an initial free interview**. However, retired-Judge Ashton Lewis gave a useful insight into this one around June/2005 when he gave a view (approximately) that this requirement of (when to provide an SoA) should and is likely to be interpreted by a court as being when you made a recommendation to a clients that you were looking to have the client ACT upon. That is a generic discussion would be outside this test. Likewise surely no professional financial advisor would be seeking to "make a product sale" during a free initial interview?

→ **Bottom line:** We believe this issue is largely solved with perhaps some minor areas still open to be problematic.

Summary on FSR refinements:

While this may not be a comprehensive assessment of the October release of the FSR refinements, our impression is that it has solved the vast bulk of issues that we have raised. Thank you very much. We now need to ensure that there is now a mechanism to fix minor issues that are uncovered from here on in.