

Geoff Miller
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Dear Sir

Since we were not able to be represented at the Sydney discussion group on 19/4/07 in Sydney, I enclose some comment (*in blue italics*) on your paper below, intermingled with the text your group has prepared.

Some really key points are made in response to your numbers as follows:

- 6
- 14.3
- 18.2
- 18.3
- 18.4
- 18.5 – this is a really big one.

Yours Sincerely

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FORUM ON REGULATION OF FINANCIAL ADVICE: BACKGROUND PAPER

Scope of advice

1. Under the *Corporations Act 2001*, the definition of financial product advice includes recommendations, statements of opinion or reports intended to influence people in making a decision about a financial product or class of financial products. Financial product advice is divided into personal and general advice. Personal advice is defined as financial product advice where the adviser has considered a client's personal circumstances in recommending a financial product, while the definition of general advice is broad and captures financial product advice that is not personal advice. Where advice provided is captured by the personal advice definition, there are additional disclosure and training requirements that apply to an adviser, including the provision of a Statement of Advice (SOA).
2. The refinements to financial services regulation in 2005 reduced some disclosure obligations that apply to personal advice in limited circumstances. Following the implementation of these refinements, further concerns were raised with regard to some operational issues with the scope of the definitions of general and personal advice, particularly the licensing, training and disclosure obligations that are triggered as part of providing personal advice.

Corporate and Financial Services Regulation Review Consultation Paper

3. The *Corporate and Financial Services **Regulation** Review Consultation Paper* (April 2006)

sought comments on the appropriate boundaries for, and between, general and personal advice -particularly whether the divide should be moved to limit when advice can be regarded as personal advice and thereby avoid the accompanying licensing and disclosure obligations.

4. In response to the Consultation Paper, a range of issues were raised with regard to the scope of the personal and general advice definitions. The perceived problems that were noted indicated that the regulatory framework around general and personal advice has potential to capture a broad range of interactions between product issuers and advisers, and their clients – which imposes disclosure obligations in situations where they may not be necessary or appropriate. This was perceived to be **creating market distortions**, most prominently in two scenarios:

4. 1 Where consumers are unable to receive **advice** regarding the appropriateness of financial products to them because the 'adviser' was not authorised to provide personal advice.

It is always dangerous for an advisor to give advice where he is not authorised to do so. Why should it be otherwise?

- 4.2 Where the definitions of general and personal advice capture situations that were not intended to be advice. Consumers are being provided with personal 'advice', including a SOA in some circumstances, in situations where they are being sold a product because these financial product issuers' agents, for example, are authorised to provide personal advice and must comply with the regulations even though they are primarily concerned with **selling** a product from a range that they are able to sell.

It makes sense for call centres to sell simple products like car and home insurance, without SoAs. The risk to consumers in these circumstances are low. Consumer do need much greater protection though where the consumer is making major financial decisions regarding their financial life.

5. Although the 2005 refinements to financial services regulation went some way to alleviate the cost burden in the provision of advice, there is scope to make the regulatory framework more practical to facilitate the provision of advice to consumers.

Corporate and Financial Services Regulation Review Proposals Paper – Proposal 1.1

6. To address the issues noted above, the sales recommendation proposal was developed. That proposal would allow financial service providers and their representatives to **choose** to make sales recommendations, as opposed to providing financial advice. Under that proposal, as part of a sales transaction a provider could **recommend** financial products based on consideration of a client's objectives, financial situation and needs without that recommendation constituting financial advice and triggering the advice requirements. Advice in relation to superannuation was proposed to be excluded from the sales recommendation regime.

It is important to get the terminology right. There is no such thing as a sales recommendation. Sales people make proposals for consideration. Advisors make recommendations.

The term "recommendation", goes to the point Sir Anthony Mason makes (see our submission) where he says

“The difficulty here is that, in reality, the adviser is a product seller, yet he is described as a licensed financial adviser, a description which endows him with a very different aura of authority and influence”

The point is the use of the term "recommendation" in the context of sales, conveys a sense that the sales proposal may in fact be objective and impartial advice.

This is problematic because under the current rules consumers have difficulty telling where they are being sold to ... and when they are getting genuine independent professional impartial objective advice.

7. In developing the proposal, the intention was to allow the regulatory framework to more closely

reflect the realities of the market with respect to distribution of financial products.

8. The proposal aimed to make clear to consumers when they would be receiving financial advice as distinct from **pure product sales** situations. A key element of the proposal was transparency to the consumer about what they were receiving. Importantly, it was proposed that those who adopted the sales recommendation regime would be required to make clear to consumers that they were only selling financial products and were not providing advice. This was proposed to be presented to the consumer through a Sales **Recommendation Proposal** Warning, which would include, among other things, disclosure on the relationships that the sales representative has with the product issuer and any commissions and conflicts of interest that exist.

It is either SALES or it is not – you cannot be half pregnant.

9. It was proposed to allow a licensed product issuer to have advice and sales recommendation authorisation. However, another key element was that at the individual level, the agent or authorised representative would only be authorised to make either sales recommendations or provide financial advice, and could not have 'two hats' at the same time. Under the proposal, individual representatives that chose to be authorised under the sales recommendation regime would not be able to provide advice, or promote themselves as an adviser. However, the intention was that a single firm might have some employees that were authorised to provide advice, and others that were only authorised to offer sales recommendations.

The consumer is likely to be very confused if the representative, can change hats – between sales and advice. Is he selling today – or is he advising today? This is likely to lead to misleading and deceptive conduct.

Reactions to proposal

10. Proposal 1.1 attracted significant debate in the submissions and the media. There is general agreement that it is a far-reaching proposal that would have significant consequences for the financial services industry.
11. The views on the proposal varied from strong support to strong disagreement. Overall, the proposal was not generally supported and in many cases, submissions suggested certain amendments or additions to the proposal in its current form, some of which are significant.
12. Irrespective of whether they supported the proposal or not, industry and consumer organisations strongly recommended further discussions on this issue to resolve outstanding problems with the definition of advice.
13. Some of the concerns with the proposal are summarised below.

Perceived consumer impact

14. Some submissions that do not support the proposal suggest that it would undermine the fundamental consumer protection that financial services regulation embodies.
 - 14.1. The proposal **assumed that consumers would be able to understand the distinction between advice and sales**, and would make a sound judgement about seeking considered financial advice, as opposed to accepting a sales recommendation. From the submissions, it appears that the majority of industry participants do not believe that consumers would be able to make that distinction.

Unless the lines are drawn very firmly, many market participants would seek to blur the lines between sales and advice intentionally. People seeking to sell while dressed up as objective advisors, like the do today – and we find this problematic for consumers – and clearly so does Sir Anthony Mason.

14.1.1. **One intention of the proposal was to address the current problem where financial service providers are, due to the definition of personal advice, being made out to be providing advice when, in essence, the service they offer is a sales recommendation.**

14.2. There was also concern that the proposal would reduce consumer protection on the basis that the 'reasonable basis for advice' obligations that apply for financial product advice would not apply to sales recommendations and consumers would not receive an SOA to document the recommendation being made.

Agreed.

14.3. *It was also suggested that the proposal would result in a significant change to the structure of the market and particularly, a reduction in the availability of financial advice if the market moved to a 'sales only' structure.*

Absolutely disagreed. It would simply exposed the reality of what actually is happening in the market today – this is absolutely a major major direction that needs to be imposed on AFS representatives – for the good of consumers.

A spade needs to be called a spade – so consumers can see what they are dealing with.

Perceived business impacts

15. A small number of submissions argue that, contrary to the objectives of simplifying regulation of financial services, the proposal would **increase complexity** for business by adding further rules and obligations, particularly for licensees that would hold authorisation for individuals to either offer financial advice or make sales recommendations.

0. Similarly, some submissions argue that the proposal would involve **increased compliance costs** by introducing an additional set of licensing obligations and training requirements.

161. The proposal sought to reduce compliance costs for those providers that are currently required to adhere to the regulatory requirements that apply to the provision of advice, where this is considered to be not necessary.

Key stakeholder views:

1. While some submissions believed that the proposal had some merit in potentially creating a distinction between advice and sales, the views on the proposal from the various sectors of the financial services industry were mixed.

17.1. **Consumer representatives were supportive** of the concept, but believed that further consideration was necessary, particularly with respect to excluding complex investment products.

Agreed. Complex products do require greater consumer protection measures. Where complex products are sold, then the same disclosure & compliance regime needs to be in place for sales as for advice providers.

17.2. The **general insurance and banking** industries supported the concept of the proposal but sought modifications to expand the scope of its operation.

- 17.3. The **funds management, superannuation, financial planning and insurance broker sectors of the financial services industry did not support the proposal (???) (not everyone)**, but suggested various amendments to the definitions of personal and general advice.

BFPPG did not support the form of the proposal – but supports the concept of sales being divided from advice.

Problems Identified

2. Based on the comments made in submissions to the proposals paper, there are nine main problems with the scope of the general and personal advice definitions.

18.1 Advice regarding low value transactions

If financial product advice relates to one (or more) transaction of a low value, then if the advisor is being remunerated by issuers based on sales, the commission that the advisor would receive may not be sufficient to compensate for the cost involved in preparing a SOA. In such situations, the advisor is likely to not offer the advice at all.

*Very clearly, there is a major problem in terms of the cost of executing low cost transactions because of the compliance burden. This relates to both new investments **AND product replacements**. There does need to be some form of waiver from the compliance burden for these transactions.*

18.2 Strategic advice

If the financial product advice provided is of a 'strategic' nature and does not recommend a product, advisors that are remunerated by issuers based on sales would not receive sufficient remuneration to compensate for the cost involved in preparing a SOA.

This is a very simple problem to fix. The representative need to charge a fee. If the consumer is not prepared to pay the fee, then the service is clearly not warranted and therefore the service should not be provided. The consumer's willingness (or otherwise) to pay a fee is a very important regulatory mechanism to determine whether a service should be performed – if anything this mechanism needs to be enhanced because there is a percentage of transactions which occur where the value of the service is far less than the commission which the sales rep receives – but the consumer goes ahead anyhow, because many consumers do not realize that this commission is in effect paid by the consumer (for example it often comes out of the up-front product fee – or the cost is built into the cost of the product).

Advice related to social security is probably an area where compensation to AFS representatives might often be in excess of the value of the advice to the consumer.

18.3 Post-acquisition advice

If the financial product advice provided relates to **choices within an** existing product (eg asset allocation or insurance options within a superannuation product):

advisors that are remunerated by issuers based on sales would not receive sufficient remuneration to compensate for the cost involved in preparing an SOA relating to post-acquisition choices; and

in some circumstances it is argued that employers and superannuation funds should be permitted to give employees some information regarding superannuation products without the expense of an SOA, training or licensing.

See response to 18.2 – if the service has real value, then the consumer will be prepared to pay an appropriate fee.

18.4 'Simple product' advice

If the financial product advice relates to a financial product that is considered simple, it is argued that the regulatory framework imposes unnecessary burdens on the provider regarding the preparation of an SOA and training of the advisors. This argument is put in relation to deposit products, general insurance and life insurance.

Agreed.

There is also another problem because currently a switch of cash in a cash management trust is caught by the product replacement section of FSR. Eg Section 947D. While technically this class of product switch does trigger Section 947D, it surely was not the intent – and therefore should be specifically excluded from being caught by Section 947D.

More generally regarding Section 947D, there is a strong case to remove this section entirely from FSR because the consumer protection sought from this section is best delivered by the following aspects of law:

- well established **common law** obligations in terms of negligence, duty of care; etc.
- **The Corporations Act 2001** requirement that:
 - ⇒ there was a reasonable basis for the advice and the advice was reasonable in the circumstances. Section 945A
 - ⇒ a licensee must "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** provision for protection in respect of:
 - ⇒ 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

18.5 Product sellers

If the person providing the financial product advice has, by way of remuneration through sales commission or otherwise, a primary business goal of selling rather than advising, there is likely to be a tension between the assumptions and obligations in the regulatory framework regarding the provision of reasonably-based advice and the commercial incentive, which can lead on occasion to confusion about the type of service being provided and consumers receiving advice that is not in their 'best interests'.

*Let us be very very clear here – the product salespeople in our industry play precisely the same role as agents did under the old **Insurance (Agents and Brokers) Act 1984**. It is just that under FSR, there is a farcical charade being played at the consumers expense that these SALES AGENTS are acting in the best interest of consumers – whereas very clearly, sale agents are acting for the vendor. It is very critical therefore that sales*

agents are very clearly labelled as sales people so that consumers can readily see who is acting for the product vendor – and who is acting for them, the consumer.

18.6 **Superannuation consolidation**

If the advice relates to the desirability of consolidating a range of superannuation accounts into a single account, it is argued that:

the advice is so simple as not of a nature to warrant preparation of SOA and/or training. An opposing view is that consolidation into a fund that might pay commission from one that does not is not simple and fall squarely within the regulatory framework for advice

in some cases. the remuneration an advisor would receive would not be sufficient to warrant the costs of preparing an SOA. This would not necessarily

be the case with all consolidations — it would depend on the magnitude of the investment in the main fund and the means of remuneration

18.7 **Call centres**

It is not practical for persons dealing with customer telephone inquiries at a call centre to prepare full SOAs. They would generally operate on a 'no advice' or 'general advice only' business model, and operators would be directed not to offer any personal advice. It is argued that consumers may be missing out on potentially useful information about the suitability of particular financial products for their situation, because operators refrain from making recommendations based on consideration of personal circumstances.

18.8 **Software**

Some issuers wish to offer software that assists consumers to select a suitable product by answering various questions. It is not practical for an SOA to be provided in relation to such software and the remuneration received, if any, may not be sufficient to offset the costs.

18.9 **Group Communication**

Some providers of advice would like to provide general information to their clients (eg by issuing a client newsletter). However, as financial planners, they will know information about their clients which might trigger the personal advice category and therefore require an SOA.