Stockbrokers and Financial Advisers Association

25 February 2022

Email: financial.services@alrc.gov.au

The Hon. Justice S C Derrington
President
Australian Law Reform Commission
Level 4, Harry Gibbs Commonwealth Law Courts Building
119 North Quay, Brisbane
QLD 4000

Dear Justice Derrington

ALRC REPORT 137
INTERIM REPORT A – FINANCIAL SERVICES LEGISLATION

The Stockbrokers and Financial Advisers Association (SAFAA) is the professional body for the stockbroking and investment advice industry, representing 8,000 professionals. Our members are Market Participants and Advisory firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SAFAA members represent the full range of advice providers from online providers providing execution-only services to full-service stockbroking.

Introduction

Thank you for the opportunity to provide feedback on Interim Report A Financial Services Legislation (the Report).

SAFAA welcomes the work of the Australian Law Reform Commission (the Commission) and has been engaging with its review team to put forward our members' views concerning the complexity of financial services laws. SAFAA's members were not called before the Hayne Royal Commission. They have however been impacted by legislative changes made as a result of its recommendations. SAFAA has been arguing for some time that the added layers of regulation imposed on the financial advice industry over some years, particularly in response to the recommendations of both the Parliamentary Joint Committee on Corporations and Financial Services inquiry into professional and education standards for financial advisersand the Hayne Royal Commission, have increased both the costs of doing business and the regulatory risk, and have made the provision of advice to retail clients more costly and less accessible. We agree with industry commentators that the pendulum of regulation has swung too far.

SAFAA also welcomes and supports the Quality of Advice Review and will be providing a submission when the final Terms of Reference are released.

SAFAA endorses the Report's comment at page 332 that the AFSL regime has a very wide scope and covers a wide variety of industry participants and business models. The biggest issue our members face is a 'one-size-fits-all' approach by government and regulators to the development of regulation and standards that are applied to all participants in the financial advice sector. Of particular concern is that government and regulators assume that all advisers are financial planners and must be subjected to regulation that best suits that speciality. This disadvantages stockbrokers and investment advice firms and their clients, as well as other specialised advice services (for example, accountants providing advice to SMSFs). It is important that regulators and government understand the way the stockbroking and investment advice industry works and fits within the broader financial advice service ecosystem.

SAFAA is supportive of principles-based regulation. However, we consider that it is important to balance principles with prescription and that there is a role for both. More importantly, we do not want our members to be subject to a 'one-size fits-all' approach.

SAFAA's members do not share views held by other parts of the financial services sector on a number of issues such as:

- individual licensing
- the general advice definition
- changing the wholesale investor test
- separating product from advice.

The 'one-size-fits-all approach' has created undesirable and unintended consequences for the stockbroking and investment advice sector. We have previously pointed out in our discussions with the Commission's review team that one of the most egregious examples of a 'one-size-fits-all' approach to financial advice impacting the stockbroking and investment advice industry was the approach by the Financial Adviser Standards and Ethics Authority (FASEA) to the education standards and Code of Ethics (which were administered by FASEA until 1 January 2022). FASEA's lack of understanding about how stockbroking and investment advice differs from financial planning provided significant challenges to the stockbroking and investment advice profession. It is an important example of the damage that can be done to an industry when those imposing standards upon it do not fully understand the way the industry works, or take a narrow view that excludes sections of the industry.

It is vital that the problems caused by a myopic approach to financial advice not be repeated and that the Commission considers the full range of financial advice services when undertaking its work. To assist with this we have set out below a summary of what stockbrokers and investment advisers do as well as our feedback on particular chapters of the Report.

General comments

What do stockbrokers and investment advisers do?

Australia has a strong culture for individual share market investment by ordinary citizens — the result of decades of public policy driving Australians in that direction. For example, the dividend imputation system was designed to encourage Australians to invest in equities, so that the benefits of corporate prosperity could be spread, and to support the use of savings to finance equity in Australian companies. Public policy encouraging demutualisations and privatisations in turn also encouraged ordinary Australians to become shareholders. In

2020, the ASX Investor Study showed that Australia continues to be a nation of investors, with close to nine million adult Australians holding investments outside their super and primary dwelling. Retail investors have been key to supporting Australian companies through investments in the listed equities markets.

Stockbrokers raise public capital for the Australian economy by means of the listing and trading of the securities of corporate entities on Australia's securities exchanges, and stockbrokers and investment advisers evaluate such securities and identify the investment opportunities they present to institutional, wholesale and retail investors. On the other hand financial planners provide a holistic general financial service covering an individual's superannuation, life insurance, welfare entitlements and aged care arrangements with the provision of investment advice in relation to the securities markets largely contracted out to specialists in the form of fund managers (managed funds) and stockbrokers (personal and SMSF portfolios).

'Stockbroker' is a defined term in the Corporations Act, as is 'Financial Planner', which clearly distinguishes them. Stockbrokers are subject to the Market, Clearing and Settlement Operating Rules of the ASX and Cboe markets of which they are a Participant and to ASIC's Market Integrity Rules, neither of which apply to financial planners. The Market Integrity Rules cover the operation of Market Participants and their representatives, client relationships, trading and capital requirements. ASIC has a dedicated ASX Participant Market Supervisory Division. Stockbrokers are also required to fund the National Guarantee Fund (NGF) to compensate clients for failures by stockbrokers. The NGF holds in the order of $100 million. The Anti-Money Laundering and Counter Terrorism Act also distinguishes stockbrokers from financial planners, as it applies to the former cohort but not the latter.

It is very common for clients of stockbrokers and investment advisers to seek advice on particular investments to buy or sell. This does not require 'holistic' or 'comprehensive' advice on the client's full financial situation, but discreet advice in relation to a client's portfolio of investments. Where stockbrokers and investment advisers provide personal advice to retail clients, in most instances this advice is limited advice: it is scaled and specific to the client's needs. The advice is client-centric, focused and scaled as to the information received from the client. It is also often episodic.

To ensure that clients understand the nature of scaled advice, stockbrokers and investment advisers clearly set out the limitations and scope of the advice in the statement of advice.

SAFAA also has members who provide online execution-only services.

Stockbroking is a fast-paced, time-sensitive service. That is why the Corporations Act was amended in 2003 to insert section 946B providing for further advice for market-traded products where clients required the advice to be provided promptly. Scaled advice can be delivered as further advice and a Statement of Advice is not required in the case of further advice. A simplified process of providing advice to the client then arises.

This approach can be contrasted with the financial planning advice model where advice is provided on all aspects of a client's financial circumstances and a full financial plan prepared. An advantage to clients of scaled advice is that they do not have to pay for the time-consuming preparation of a financial plan and this reduces the overall costs of advice and allows advice to be provided in a more timely or immediate fashion. Some stockbroking firms provide financial planning services and clients are informed of this so they can avail themselves of this service if they require it.

ASIC research highlights that many consumers prefer receiving piece-by-piece or limited advice, rather than comprehensive advice[1] and that in terms of topics of interest, 45% of consumers had either received advice on or were interested in receiving advice on investments such as shares and managed funds[2].

Scaled advice is expressly permitted under the Corporations Act as evidenced by the following commentary which has been included at section 961 B(2) ('Safe Harbour' provisions).

> *Note: The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.*

A scaled investment advice model should allow clients to access research and investment advice at a reasonable cost. It should be able to be provided without the need for the provision of extensive personal information or for a comprehensive needs analysis to be performed which is generally of limited relevance to the advice sought and significantly adds to the time and cost of the advice process.

Report: Chapter 3
Empirical data

In answer to Question A1 and as previously discussed, SAFAA recommends that the Commission consider the Code of Ethics issued by FASEA in order to understand the legislative complexity faced by stockbrokers and investment advisers.

SAFAA has long expressed concern about the wording of Standard 3 and sought its revision. We consider that the Standard remains unworkable in practice, particularly in light of the lack of a test of materiality or proportionality and that it conflicts with the law. We note that FASEA at the close of 2021 conducted a consultation offering three options in relation to Standard 3, of which two proposed revisions of the Standard and one retention of the status quo. However, despite 80% of respondents favouring Option 1 which proposed a revision of the wording of the Standard, FASEA declined to make any changes.

SAFAA has also long argued that Standard 6 of the Code is an impediment to the provision of scaled or limited advice and is inconsistent with section 961B of the Corporations Act. We consider that continuation of Standard 6 in its current form will also defeat any efforts by ASIC to provide meaningful guidance on scaled advice. SAFAA has called for Standard 6 to be removed from the Code. We note that Standard 6 assumes that all financial advisers are financial planners — a consequence of the 'one-size-fits-all' approach set out earlier.

Report: Chapters 4 and 5
When to define and consistency of definitions

SAFAA supports Recommendations 1 to 6 on when to define terms and consistency of definitions.

[1] ASIC report 224 Access to financial advice in Australia

[2] ASIC report 627 Financial advice: What consumers really think

SAFAA considers that the application of the proposed definitional principles on when to define and the consistency of definitions contained in Question A2 would reduce complexity in corporations and financial services legislation and are sensible suggestions.

Report: Chapter 6
Design of definitions

SAFAA supports Recommendations 7 to 12 on the design of definitions.

Report: Chapter 8
Licensing

We note that the Commission considers that the issue of individual licensing of advisers should be explored further in the Quality of Advice Review. The issue of individual licensing is not explicitly included in the draft terms of reference of that review; however, that may change as the terms are finalised.

Again, individual licensing is not a proposal that works for stockbrokers or investment advisers. As the Report notes (at page 331) the AFSL regime is a core component of the financial services regulatory ecosystem and has a wide scope, covering, inter alia, brokers, dealers, market makers, underwriters, financial advisers, credit rating agencies, custodians and depositories, crowd-sourced funding platform operators, margin lenders, responsible entities of registered managed investment schemes and operators of direct distribution foreign passport funds, issuers of exchange traded funds, derivatives and structured products and litigation funders. Unlike other professions such as law and medicine, the licensing regime for financial services has always applied at an organisational level. The report notes at page 332 that prior to the current AFSL regime, licensing requirements under the Corporations Act applied to securities dealers, investment advisers, futures brokers and futures advisers and their proper authority holders.

Individual licensing applies a financial planning lens to financial services legislation and would require our members to squeeze into a framework that does not suit them or their clients. SAFAA points to the difference between stockbroking and investment advice firms and many financial planning businesses, as a matter that needs to be taken into account. Many financial planning businesses are small businesses or SMEs. Stockbroking and investment advice firms, on the other hand, are large businesses and becoming larger, given they operate in global markets and provide time-related advice, including reaching out to thousands of clients instantly for capital raisings and rights issues. The investment required for such firms is very different to the investment required for financial planning firms providing advice on taxation and superannuation law. Amalgamations are underway to provide scale in the stockbroking and investment advice industry to meet those investment requirements.

Efficiency in larger firms is generated through active oversight by compliance departments. We note that the understanding by all those operating within an AFLS that any misconduct by an individual within that entity has a detrimental impact on the reputation of all as well as the entity itself is an important factor in creating a culture whereby individuals promote ethical and law-abiding practices. If individual licensing were introduced, any misconduct would be the responsibility of an individual alone and would have no bearing on the reputation of others operating within the AFSL or the entity itself. There would therefore be no incentive for others to support a culture promoting ethical and law-abiding practices. Issues concerning the availability of PI insurance would also arise in the event individual licensing was introduced.

If the issue of individual licensing is included in the final terms of reference of the Quality of Advice Review, SAFAA will be putting forward our members' views.

Report: Chapter 9
Disclosure

SAFAA notes that the improvement of the clarity and availability of documents and disclosures is part of the draft terms of reference for the Quality of Advice Review. The findings and recommendations contained in the Report will be very valuable for that review.

Report: Chapter 10
Exclusions, exemptions and notional amendments

SAFAA agrees that exclusions, exemptions and notional amendments make the law difficult to navigate, make the regulatory regime opaque and compound the existing level of complexity in the legislative regime. As we have previously raised with the Commission, drafting practices that are extremely broad in application and inadvertently capture matters that are not intended (what we would call a ''kitchen sink'' approach to legislative drafting), often necessitate carve-outs and exclusions by way of regulation, legislative instrument or ASIC modification in order to restore Parliament's intent.

An example of this drafting approach is the breach reporting provisions in the *Financial Sector Reform (Hayne Royal Commission Response) Act* 2020.

SAFAA provided a submission to Treasury on the exposure draft of the bill on 28 February 2020 expressing concerns about the changes to the breach reporting regime around the 'significance' threshold. The new provisions 'deemed' a contravention of a civil penalty provision to be a significant breach. We pointed out that this would result in a large increase in breach reports for minor, technical or inadvertent breaches that would not otherwise be significant.

For example, the provisions would result in a minor matter such as sending a Financial Services Guide to a client a day late trigging a requirement to lodge a breach report. A matter of particular concern for SAFAA's members was the incorporation of the ASIC Market Integrity Rules into the list of 'Core Obligations' to which the 'deeming' provision applied that would result in even minor breaches of the Market Integrity Rules having to be reported to ASIC as a significant matter. Clearly this result was not intended by Parliament, as regulations were later passed that 'carved out' or prescribed certain civil penalty provisions that were not taken to be significant under the relevant breach reporting regime.

While SAFAA commended the regulations as a sensible solution to the problem we previously highlighted, a better legislative outcome would have been for the original legislation to have been more thoughfully drafted to only include those breaches that the government considered were important enough to be reported. A person reading the current breach reporting provisions would therefore need to be aware of the regulations carving out certain civil penalty provisions in order to understand their legal obligations. This is just one example of how exclusions and carve-outs in the Corporations Act are often caused by drafting that takes an approach that is too broad.

SAFAA supports proposals that would create a single source of exclusions and class exemptions to help users navigate the relevant provisions.

Report: Chapter 11
Definition of financial product advice

We note that the definitions of 'financial product advice', 'general advice', 'personal advice', as well how they are used, how they are interpreted by consumers, and whether they could be simplified or more clearly demarcated are included in the draft terms of reference for the Quality of Advice Review.

We note that there have been suggestions that general advice should be renamed as 'information', or 'product sales information'. General advice remains a relevant advice category for SAFAA's members distinct from the provision of factual information. Research reports on listed securities relevantly comprise general advice. They are not sales or advertising information, but valuable intellectual property. SAFAA would be concerned if changes were made to the definition of general advice that resulted in general advice being reclassified as 'information' or 'product sales information' even when it contained a product recommendation. This would have significant implications for the provision of research reports on listed securities. Investors are unlikely to ascribe value to material that is defined as 'information' as they would consider that they can obtain that themselves on the internet.

Calls for a change in the definition of the term general advice is one example of where a 'one-size-fits-all' approach to financial services regulation does not work for stockbrokers and investment advisers and we will be raising this issue in the Quality of Advice Review.

Report: Chapter 12
Definitions of retail client and wholesale client

We note that the processes through which investors are designated as wholesale clients are included in the draft terms of reference for the Quality of Advice Review.

SAFAA recently issued our discussion paper *Does the wholesale investor test need to change*? that addresses the increase in calls for changes to the wholesale investor test as well as the impact on advisers and their clients. The paper questions whether there has been a sufficient identification of harm to investors in recent calls to justify amendment of the wholesale investor test and whether the significant disruption to clients and advisers that would arise from any change to the definitions can be justified in light of the impact it would have on access to and affordability of advice.

SAFAA considers that a key question requiring consideration is whether a reference to outlier misconduct should be utilised to disrupt significant numbers of clients' investment strategies and licensees' business models. Recent calls for change take the view that a range of Australian investors should be excluded from accessing investment opportunities due to outlier misconduct or the potential for outlier misconduct.

We consider that calls for change to the wholesale investor test appear to be a solution looking for a problem. Given the significant implications for stockbrokers, investment advisers and their clients, should any change to the wholesale investor test be introduced, it is important that any call for change be supported by evidence. A key question is whether the voice of the client has been sought. Before embarking on any further reform we consider that is important to seek the views of wholesale clients who will be impacted by any change.

SAFAA will be providing our discussion paper to the Quality of Advice Review.

The link to our discussion paper is here.

Report: Chapter 13
Conduct obligations

Consideration of the safe harbour provision for the best interests duty is included in the draft terms of reference for the Quality of Advice Review and SAFAA will be providing feedback on that matter as part of that process.

Conclusion

If you require additional information or wish to discuss this matter in greater detail please do not hesitate to contact SAFAA's Policy Manager, Michelle Huckel, at [redacted]

Kind regards

[redacted]

Judith Fox
Chief Executive Officer