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The Australian Law Reform Commission (ALRC)
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AFA Submission: Review of the Legislative Framework for Corporations and Financial Services Regulation

Introduction

The AFA welcomes the opportunity to provide feedback to the Australian Law Reform Commission on Interim Report A of the Review of the Legislative Framework for Corporations and Financial Services Regulation.

We are conscious that this review is more focussed on the architecture of the law and the impact that has on complexity. We note that the focus is not intended to be the recommendation of policy change, however we hope that this review will help to highlight a number of fundamental policy issues that must be addressed to reduce the level of complexity and the resultant level of inefficiency.

In the financial advice space, in the context of a significant reduction in financial advisers, many Australians have lost access to financial advice. This needs to be addressed by measures that will reduce the cost of providing financial advice and enabling more Australians to access financial advice that they can afford.

In our submission, we have focussed our responses on matters more directly related to financial advice.

Interesting and Relevant Case Studies

We present the following case studies to provide useful examples of complexity that causes confusion and inefficiency. In our view, some focus on what has gone wrong with regulatory change in recent years, helps to identify the underlying fundamental problems and to clarify what needs to change in the future.

Financial Adviser Exam Deadline

Prior to a further extension to the financial adviser exam deadline through the Better Advice Bill in 2021, it was broadly understood that all financial advisers needed to complete the FASEA exam before 31 December 2021, or otherwise they would no longer be able to practice and could only re-enter the advice profession through the new entrant pathway.

This was until the CEO of FASEA made a comment at a Senate Estimate hearing in June 2021. It emerged that this deadline might not apply to financial advisers who were off the Financial Adviser Register as at the date of the deadline. As it turned out, this outcome was achieved by an ASIC legislative instrument (ASIC Corporations (Professional Standards—Transitional) Instrument 2018/894) that was issued in October 2018, that modified the key section in the Corporations Act (Section 1546B) that set out the workings of these deadlines. ASIC Instrument 2018/894 actually predated the first extension of the exam deadline from 1 January 2021 to 1 January 2022, so it was to that extent somewhat questionable.

This career break exemption was not known or understood as it was an outdated ASIC Instrument that modified the Corporations Act. There was a complete lack of understanding of this provision, which might have led to financial advisers being misled about their options.

Breach Reporting Complexity

The Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 completely re-wrote the AFSL breach reporting obligations and introduced an incredibly complex piece of legislation, which at the core of it would require licensees to understand whether any particular breach was an offence warranting a defined period in jail or a civil penalty provision. Over time the Government introduced through regulations and also through ASIC instruments, certain exemptions for particular provisions. All up, the design of the new breach reporting regime has become incredibly complex, and virtually unworkable for small licensees without access to legal or compliance resources. The legislation should not be designed in a way where legal advice becomes unavoidable. This is entirely counterproductive and inefficient.

Providing an FDS the Day after the Period Ended

The Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020 introduced the Annual Renewal and Client Consent form requirements for financial advisers. The legislation was passed in late February 2021 and was due to commence from 1 July 2021. The law that was passed actually required Fee Disclosure Statements (FDSs) to be issued the day after the period that they were expected to cover during a one year transition period, rather than having the normal 60 days to issue them. Following the identification of this problem, the Government were forced to issue a regulation that permitted financial advisers to use an estimate of the fees for the last two months of the 12 month period. This was necessary as any error in the FDS would invalidate the ongoing fee arrangement. Given that often, fees that are taken out of the client's account are not paid immediately to the financial adviser, this was an impossible expectation. Due to the discovery of this issue, the guidance from ASIC was delayed and only came out in June 2021.

This case study highlights two main problems, overly complex legislation and commencing legislation too quickly, without the opportunity to understand and implement.

Timing Differences with FDS

The 2012 Future of Financial Advice legislation introduced the requirement for financial advisers to do Fee Disclosure Statements (FDSs). The advice sector, including a range of service and system providers, designed the production of FDSs on the basis of the amount and the timing of the receipt of fees by the financial advice licensee. The problem is that fees could be taken out of a clients account in one period and paid to the adviser in the next period. Also, there could be small differences in the amounts disclosed that are related to the different tax treatments (i.e. GST/RITC).

ASIC issued Report 636 “Compliance with the fee disclosure statement and renewal notice obligations” in November 2019, some seven years after the FDS legislation was passed and mentioned these timing differences and amount differences, noting that these differences would result in the invalidation of the FDS. ASIC recommended that advice practices log into product systems to manually check that FDSs contain the correct amounts, in terms of what came out of the clients account in the defined period. This is incredibly inefficient.

This case study highlights a number of issues, including the fact that the entire sector built solutions, that were later assessed as unsatisfactory by the regulator and then the legislation provided absolutely no room for discretion in making small errors (timing or tax treatment) and also that these small differences would invalidate the entire ongoing fee arrangement. Concerningly, this issue remains unresolved, and was not fixed by the Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020, despite that fact that it was directly relevant to FDSs.

Expectations for Servicing Clients

The Fee for No Service scandal has been a huge issue for financial advice. The reality of the issue is much more complex and has never been adequately disclosed. There was no regulatory guidance on what services advisers were required to provide as part of an ongoing fee arrangement and what records needed to be kept. ASIC issued an information sheet (232) in 2018 and set down some expectations. In this information sheet they set out the view that an annual review was the primary service that was provided and that as a result there would need to be proof of the provision of an advice document.

This information sheet was widely applied, including in a retrospective sense, and it has led to significant remediation programs. The legal basis for this remediation goes back to contract law, however it is also linked to Section 912A of the corporations Act and the requirement to operate efficiently, honestly and fairly.

We do not deny the importance of the Fee for No Service issue, however the predominant reliance upon an annual review, and the demand for proof, does not reflect the reality that clients get value from other services and do not always agree to participate in an annual review. The retrospective application of standards, through an information sheet, with such broad implications is not, in our view, the best solution for such an important issue.

Responding to Consultation Questions

A1. What additional data should the Australian Law Reform Commission generate, obtain, and analyse to understand:

- **a. legislative complexity and potential legislative simplification;**
- **b. the regulation of corporations and financial services in Australia; and**
- **c. the structure and operation of financial markets and services in Australia?**

The information presented by the ALRC in Part 1 of the interim report is excellent, painting a picture of the overwhelming nature of the financial services legislation in the Corporations Act. This paints a very clear picture of the complexity of the legislation.

We believe that this data can be supplemented by examples, such as the case studies addressed above, which bring to light the complex nature of the law and how this complexity can lead to other issues such as fundamental different understandings, poor drafting and inefficiency in the application in practice.

A2. Would application of the following definitional principles reduce complexity in corporations and financial services legislation?
When to define (Chapter 4):

> **a. In determining whether and how to define words or phrases, the overarching consideration should be whether the definition would enhance readability and facilitate comprehension of the legislation.**
> **b. To the extent practicable, words and phrases with an ordinary meaning should not be defined.**
> **c. Words and phrases should be defined if the definition significantly reduces the need to repeat text.**
> **d. Definitions should be used primarily to specify the meaning of words or phrases, and should not be used to impose obligations, tailor the application of particular provisions, or for other substantive purposes.**
> **Consistency of definitions (Chapter 5):**
> **e. Each word and phrase should be used with the same meaning throughout an Act, and throughout all delegated legislation made under that Act.**
> **f. Relational definitions should be used sparingly.**
> **g. To the extent practicable, key defined terms should have a consistent meaning across all Commonwealth corporations and financial services legislation.**
> **Design of definitions (Chapter 6):**
> **h. Interconnected definitions should be used sparingly.**
> **i. Defined terms should correspond intuitively with the substance of the definition.**
> **j. It should be clear whether a word or phrase is defined, and where the definition can be found.**

We support all the points raised above, which get to the core of complexity that is created by different definitions for the same term, unnecessary definitions and the use of definitions to impose obligations.

A3. Each Commonwealth Act relevant to the regulation of corporations and financial services should be amended to enact a uniform definition of each of the terms 'financial product' and 'financial service'.

The definition of 'financial product' and 'financial service' are critical for the financial services industry and consistency in the definition and consistency in the understanding of the definition are particularly important.

A8. The obligation to provide financial product disclosure in Part 7.9 of the Corporations Act 2001 (Cth) should be reframed to incorporate an outcomes-based standard of disclosure.

We support this broad intent. Disclosure obligations are particularly prescriptive right across financial services, which often disconnects from the intended purpose, which is to achieve a level of consumer understanding. The current disclosure regime leads to placing a predominant focus upon definitive compliance and less of a focus upon the consumer outcome. Different clients have different preferences for how they consume information. We believe that it is appropriate to more carefully consider how clients want to receive this disclosure information, and what is most important to them.

Whilst it does not relate to Part 7.9 of the Corporations Act, in the Fee Disclosure Statement case study discussed above, we understand that the client needs to understand what fees they are paying for ongoing financial advice. The outcome is that they understand these fees and have the ability to choose to continue to receive the ongoing services, or not. The disclosure should not be deemed non-compliant because of timing differences or differences due to the treatment of taxation, which will have minimal impact on the overall amount reported. The focus on it being precisely correct to the nearest cent, does not reflect the needs of clients and only adds to inefficiency.

A9. The following existing powers in the Corporations Act 2001 (Cth) should be removed:

a. powers to grant exemptions from obligations in Chapter 7 of the Act by regulation or other legislative instrument; and

b. powers to omit, modify, or vary ('notionally amend') provisions of Chapter 7 of the Act by regulation or other legislative instrument.

We appreciate the reservations about these powers to grant exemptions and to omit, modify or vary, however in our view this proposal presents a double edged sword. If the existing law was clear and well understood and had been well drafted and the consequences of it were well understood and the legislation had been subject to both a comprehensive consultation exercise and a thorough Regulation Impact Statement had been prepared, then we could support this. Too often legislation has been drafted too quickly, not subject to adequate review and there has been no Regulation Impact Statement. We have listed case studies above, including the one on the Annual Renewal and FDS requirements in the Financial Sector Reform (Hayne Royal Commission Response No. 2) Bill 2020, that highlight this. In the absence of powers for the Government to amend this through regulation, the financial advice sector would have been faced with an impossible task, with the consequences that non-compliance with an impossible piece of legislation would have led to the automatic termination of existing adviser-client relationships, with serious consequences for both clients and their adviser.

So whilst we can support this in principle as a long term objective, it is based upon achieving a quantum leap in the state of the regulatory regime first.

It is also important to note the difference between the application of exemption powers for legitimate reasons to address unintended consequences and the use of these powers to create additional obligations. The former is consistent with the intended purpose, whereas the later is not.

A10. The Corporations Act 2001 (Cth) should be amended to provide for a sole power to create exclusions and grant exemptions from Chapter 7 of the Act in a consolidated legislative instrument.

We fully support the idea of having a consolidated legislative instrument, that is inclusive of all regulations and ASIC instruments. This is a great idea in concept, however the effectiveness of it will depend upon how it is organised and how easy it is to find relevant content.

A11. In order to implement Proposals A9 and A10:

a. Should the Corporations Act 2001 (Cth) be amended to insert a power to make thematically consolidated legislative instruments in the form of 'rules'?

b. Should any such power be granted to the Australian Securities and Investments Commission?

We support the concept of a rule book, however we note that the Corporations Act covers many different sectors and if there was one rule book that covered all sectors, then it would only address a small subset of the current problems in the regulatory regime. We would support the application of sector specific rule books.

In considering this, it is necessary to say that typically in practice, financial advisers would rarely review the source legislation and regulations. They would instead refer to the licensee standards that are issued by their licensee. Often it is the licensee staff and their advisers who are doing the detailed analysis and interpretation of the legislation.

We also note that consideration needs to be given to how the ASIC regulatory guidance would sit alongside the rule book.

A12. As an interim measure, the Australian Securities and Investments Commission, the Department of the Treasury (Cth), and the Office of Parliamentary Counsel (Cth) should develop a mechanism to improve the visibility and accessibility of notional amendments to the Corporations Act 2001 (Cth) made by delegated legislation.

We agree with this proposal, and as highlighted in the case studies above, it is evident that some critically important instruments can exist, but remain out of the sight of the regulated population, and not be updated when related legislation is changed.

Whilst we note that we support this proposal, we are also very conscious that it is very difficult to implement, and potentially the benefit will be short lived if the underlying objectives of the ALRC Review can be achieved in the legislation.

A13. The Corporations Act 2001 (Cth) should be amended to:

> **a. remove the definition of 'financial product advice' in s 766B;**
> **b. substitute the current use of that term with the phrase 'general advice and personal advice' or 'general advice or personal advice' as applicable; and**
> **c. incorporate relevant elements of the current definition of 'financial product advice' into the definitions of 'general advice' and 'personal advice'.**

The AFA would support changes to the definition of financial advice. The connection of financial advice to financial products is problematic and has been for a long time. It unnecessarily links financial advice to advice with respect to financial products. We appreciate that this is a core part of the construct of the Corporations Act, however it is appropriate for this to be reviewed.

There are substantial differences between personal advice and general advice and therefore we are hesitant about there being a definition of 'general advice and personal advice'. We would instead support separate definitions for 'personal advice' and 'general advice'. We expect that it would be necessary to incorporate elements of the definition of 'financial product advice' into the definitions of 'general advice' and 'personal advice'.

A14. Section 766A(1) of the Corporations Act 2001 (Cth) should be amended by removing from the definition of 'financial service' the term 'financial product advice' and substituting 'general advice'.

We support the removal of 'financial product advice' from the definition of 'financial service', and the replacement with 'general advice', noting that this then leads to the separation of personal financial advice from financial services, which is something that has much broader implications.

A15. Section 766B of the Corporations Act 2001 (Cth) should be amended to replace the term 'general advice' with a term that corresponds intuitively with the substance of the definition.

The term that applies to 'general advice' has been subject to debate for many years. This is considered by many to be an important issue, as people getting 'general advice' might assume that they are getting advice that is tailored to their personal circumstances, when it is not. The flaw in this is that consumers do not understand what general advice is and do not think in terms of the distinction between personal advice and general advice. They may however latch on to the term advice. This suggests that the problem is most directly related to the use of the word 'advice' in 'general advice'. The reality, is that, and going back to Section 766B, general advice does involve a recommendation with respect to a particular financial product or class of product. This might take the form of comments made in a financial seminar, about employees above a threshold level of income utilising the option to salary sacrifice into superannuation. Whilst superannuation is not a specific product, it is a class of product. This is a recommendation, however it is not based upon consideration of the clients personal circumstances. It is general advice and not product information or any other alternative wording for general advice. This issue also highlights the problem with the inclusion of class of product in the definition of financial product advice.

In solving this issue, we need to consider whether it is appropriate for someone to make a recommendation to a person with respect to a financial product or class of financial product without considering the client's personal circumstances. Preventing the provision of general advice would impact the ability to provide financial education. If the reference to class of product was removed from the definition of financial product advice, and it was possible to talk about classes of product within the delivery of general advice, but not specific financial products, then this might create a solution, that would be worthy of further consideration. Advice that does not recommend a specific product, is less likely to be subject to conflicts of interest and is actually more likely to be treated as education, rather than lead to the advice being implemented.

This is not an easy issue to resolve. We are not certain that there is a better term for 'general advice', within the construct of the current regime.

A16. Should the definition of 'retail client' in s 761G of the Corporations Act 2001 (Cth) be amended:

- **a. to remove:**
    - **i. subsections (5), (6), and (6A), being provisions in relation to general insurance products, superannuation products, RSA products, and traditional trustee company services; and**
    - **ii. the product value exception in sub-s (7)(a) and the asset and income exceptions in sub-s (7)(c); or**
- **b. in some other manner?**

The distinction of clients between retail and wholesale has some very substantial implications. Wholesale clients are not required to receive the same disclosure documents and are not covered by the same dispute resolution regime. It is also the case that they are not subject to the Best Interests Duty and related obligations and their adviser is not subject to the same education and conduct standards.

Since the distinction came into play under FSRA, the differences, in a broader context, between retail clients and wholesale clients has become substantially greater. It might be questioned as to whether these differences are still appropriate. It might therefore be that there is a deeper question about the appropriateness of the entire wholesale client regime, rather than just a focus upon the definition of wholesale client.

We understand why general insurance clients and superannuation clients are automatically treated as retail clients. In many ways this makes sense, and we are not aware of strong arguments to change this.

Much of the focus on this issue has been with respect to the lack of any indexation of the thresholds for wholesale clients over the last 20 years. This is a fair point, and worthy of reconsideration, however we think that the time has come to reassess the entire gap between the treatment and protections for retail clients versus wholesale clients.

A17. What conditions or criteria should be considered in respect of the sophisticated investor exception in s 761GA of the Corporations Act 2001 (Cth)?

We are less concerned with respect to the definition of sophisticated investor, which focusses upon the persons ability to understand the nature and risks of the product that they are investing in. That is a reasonable test, if this exemption is employed appropriately. This is not an issue that is subject to thresholds. Importantly it is focused upon client outcomes and suitability for making investment decisions.

A18. Should Chapter 7 of the Corporations Act 2001 (Cth) be amended to insert certain norms as an objects clause?

We are not convinced that the inclusion of norms in the Corporations Act will deliver any great benefits. It is likely that they would reflect what the law already says and therefore be of somewhat limited additional value. We believe that norms have a place in Codes, more so than they do in the law itself.

A19. What norms should be included in such an objects clause?

Please refer to our response above.

A20. Section 912A(1)(a) of the Corporations Act 2001 (Cth) should be amended by:

> **a. separating the words 'efficiently', 'honestly', and 'fairly' into individual paragraphs;**
> **b. replacing the word 'efficiently' with 'professionally'; and**
> **c. inserting a note containing examples of conduct that would fail to satisfy the 'fairly' standard.**

Section 912A(1)(a) of the Corporations Act is a critical part of the entire Act. It does set high level expectations in terms of conduct and has been used extensively as part of enforcement activity. As mentioned above under case studies, Section 912A(1)(a) was the central driver of the Fee for No Service remediation program. This points to the very wide scope in the application of this section, and also why it is important that the definition of these important terms is clear and broadly understood.

We therefore support the separation of these terms into individual paragraphs.

We also support the change from 'efficiently' to 'professionally', which we believe is a more appropriate and clearer obligation.

We also support the inclusion of examples in notes.

A21. Section 912A(1) of the Corporations Act 2001 (Cth) should be amended by removing the following prescriptive requirements:

> **a. to have in place arrangements for the management of conflicts of interest (s 912A(1)(aa));**
> **b. to maintain the competence to provide the financial services (s 912A(1)(e));**
> **c. to ensure representatives are adequately trained (s 912A(1)(f)); and**
> **d. to have adequate risk management systems (s 912A(1)(h)).**

We believe that these obligations in Section 912A are clear and are appropriate for licensees. We also believe that the specificity in these requirements is beneficial for licensees. These obligations are addressed in detail in the regulatory guides. We are not convinced that there is a strong enough argument for the removal of these requirements.

A22. In accordance with the principle that terminology should be used consistently to reflect the same or similar concepts, s 991A of the Corporations Act 2001 (Cth) and s 12CA of the Australian Securities and Investments Commission Act 2001 (Cth) should be repealed.

To the extent that these obligations are addressed elsewhere and there is an issue with inconsistency of the obligations with respect to unconscionable conduct, we support the repealing of these sections.

A23. In accordance with the principle that terminology should be used consistently to reflect the same or similar concepts, proscriptions concerning false or misleading representations and misleading or deceptive conduct in the Corporations Act 2001 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) should be consolidated into a single provision.

To the extent that there is duplication in the obligations with respect to false, misleading and deceptive conduct, we support the proposed rationalisation.

A24. Would the Corporations Act 2001 (Cth) be simplified by:

> **a. amending s 961B(2) to re-cast paragraphs (a)–(f) as indicative behaviours of compliance, to which a court must have regard when determining whether the primary obligation in sub-s (1) has been satisfied; and**
> **b. repealing ss 961C and 961D?**

We support the recommendation that the Best Interests Duty Safe Harbour be reframed as indicative behaviours of compliance. The Safe Harbour in Section 961B(2) has become a very prescriptive tightly applied obligation that has unfortunately added significantly to the complexity and cost of providing financial advice. Whilst this may not have been the original intent, it has become the outcome. This is in part due to the approach that ASIC has taken to the enforcement of the Best Interests Duty and their Project 515 that has lead to a very checklist based approach by the groups that this project applied to.

We support the repeal of section 961C, as this does not add greatly to a common-sense interpretation of reasonably apparent.

In terms of Section 961D, we also support the repeal of this section, however suggest that the key point within it, that an adviser must consider a product that the client specifically requests be considered, should be included as a note under Section 961B(2).

Concluding Comments

The AFA thanks the ALRC for the opportunity to contribute to this review and for the extension that we have received in responding to the interim report. We strongly support the efforts of the ALRC in this review and in the interim report to identify ways and means of reducing the complexity of the financial services law. This is a huge challenge and we hope that our input above, will play a useful role in the further work that the ALRC will undertake.

About the AFA

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 75 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

With the exception of Independent Directors, the Board of the AFA is elected by the Membership and Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

We would be happy to discuss this matter further, or to provide additional information if required. Please contact us on [redacted]

Yours sincerely,

[redacted]

Phil Anderson
Chief Executive Officer
Association of Financial Advisers Ltd