FINANCIAL SERVICES COUNCIL

Financial Sector Reform (Hayne Royal Commission Response – Protecting Consumers (2020 Measures) Bill: Ongoing Fee Arrangements and Disclosure of a Lack of Independence. (FSRC Recommendations 2.1 and 2.2): Exposure Draft (**ED**)

Financial Services Council (**FSC**) Submission
28 February 2020

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FSC FINANCIAL SERVICES COUNCIL

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC welcomes the opportunity to provide a submission on the Exposure Draft **(ED)** legislation to implement the following Financial Services Royal Commission **(FSRC)** Recommendations relating to the regulation of financial advice:

- Recommendation 2.1 – Ongoing fee arrangements **(OFAs)** and payments for financial advice
- Recommendation 2.2 – Disclosure of a lack of independence

The FSC supports these recommendations in principle and proposes minor or technical changes formulated by our members to ensure the legislation is practical, effective and serves the interests of consumers. This also aligns with the FSC's broader priority of ensuring accessible and affordable financial advice over the long-term.

The timelines for commencement by which these provisions take effect should be revised to allow for an orderly transition to these new requirements and a seamless experience for consumers with minimal disruption. Several provisions of the ED could be amended to best achieve this, and they are outlined in the latter sections of this submission.

The implementation of the FSRC's recommendations occurs against the backdrop of a decade of continual financial services reform. Technical changes can go a long way to ensure the legislation is fit for purpose and effective in meeting the expectations of Australian consumers in the long-term.

3. Summary of our views

The FSC makes the following recommendations to ensure the proper and effective implementation of FSRC Recommendations 2.1 and 2.2:

- Commencement of the legislation one year from Royal Assent to allow for advice business compliance systems reasonable time to become fully compliant
- A transitional timeframe applied to all existing arrangements entered prior to the commencement date whether 1 July 2020 or a later date, and that the commencement giving effect to this provision take effect from 1 January 2021
- Inclusion of a materiality threshold for isolated or immaterial record keeping errors when applying civil penalties
- A waiver period of the renewal period for up to 90 days only in a strictly limited set of circumstances such as when a client cannot be contacted and their OFA is at risk of termination.
- Definition and clarity regarding the concepts and process around consent

4. Provisions implementing FSRC Recommendation 2.1

Recommendation 2.1 proposes amendments to the Corporations Act 2001 (Cth) **(Corporations Act)** to require[1]:

- ongoing fee arrangements to be renewed annually;
- fee recipients to disclose in writing the total fees that will be charged
- fee recipients to set out the services that will be provided during the following 12-month period; and
- written consent to be obtained from a client before fees must be obtained under an ongoing fee arrangement can be deducted from that client's account.

The FSC supports the implementation of this recommendation. The FSC proposes technical amendments to the proposed legislation and regulations to allow for practical and effective implementation of the ED's provisions resulting in reduced costs and disruption for consumers.

4.1 Written consent to deduct a payment of fees under an OFA

The ED contemplates, and the FSC supports, ASIC prescribing by legislative instrument the determining relevant requirements for the giving of consent. The FSC welcomes this proposal to standardise the process in industry. This process should not unduly raise the cost of providing advice and should involve a clear process for advisers and consumers.

Much of the transparency measures that occur within client-advisor transactions include:

- Statements of Advice **(SOAs)**
- Fee Disclosure Statements **(FDSs)**
- Product Disclosure Statements **(PDSs)**

A clear, streamlined manner of obtaining consent is necessary. It can improve efficiency and deliver certainty as industry adapts to significant changes. Many licensees have their own processes in place for obtaining consent. Standardising this process across industry by ASIC should be robust but the pressure this could place on ASIC should be considered. Standardisation should occur as soon as possible and well before the commencement of the proposed provisions to allow enough time for implementation.

In addition to capturing client consent to deduct fees from their account, the FSC recommends ASIC consider the following as part of their prescribed form:

(a) Confirmation that services were provided in the preceding 12 months (where applicable e.g. renewal of an existing arrangement)

[1] Page 3, Explanatory Memorandum. Australian Government https://treasury.gov.au/sites/default/files/2020-01/c2020-48919m-explanatory-memorandum-rec2_1-final.pdf

(b) Where fees are to be deducted from a superannuation account, confirmation that the fees are only being deducted for advice/services provided in relation to the client's superannuation account

It is expected ASIC will engage should actively engage with industry as it develops a written consent standard. Consideration should also be given to the linkage between implementing Recommendation 2.1 and the Code of Ethics for financial advisers, as well as FASEA's Guidance that presently remains subject to ongoing consultation.

4.1.1 Clarification sought on the frequency of obtaining written consent from clients

The FSC welcomes clarification on how frequently a client's written consent to deduct a payment of fees relating to an OFA needs to be renewed. The Explanatory Memorandum suggests that such consent be renewed annually.

However, the proposed drafting of the ED indicates that the consent only lapses when the client terminates it (s.962U) or when the OFA is terminated or is otherwise not renewed (s.962V). This should be clarified.

4.1.2 Clarification sought on the definition of 'account provider'

The FSC welcomes clarification as to which entity would be the '*account provider'* for the purposes of receiving the client's consent. For example, in an Investor Directed Portfolio **(IDPS)** structure, would the '*account provider'* be the IDPS operator? or the bank where the member's cash account is held? In a superannuation fund scenario would the '*account provider*' be the superannuation trustee?

4.2 Clarity needed on the process of obtaining consent

Clarification is needed as to the fact rules for consent with respect to ongoing financial agreements and non-ongoing financial arrangements.

Under the ED, for an OFA consent is sought by the adviser from the client and passed onto the provider. For non-ongoing arrangements a client can directly provide consent to the adviser.

The proposed legislation for OFAs should be aligned with the provisions set out in the EDs for advice in superannuation.

Implementation should not have the unintended consequence of duplicated consents, increased costs, or confusion for consumers. Better alignment of these provisions now rather than in the future can prevent disruption for consumers and ensure the rules governing these financial advice transactions are fit for purpose in the long-term.

4.2.1 Definition of control for the purposes of obtaining consent

It is not immediately clear what constitutes 'control' for the purposes of determining a third party's obligations prior to, or as part of, arranging a deduction on behalf of a fee recipient.

FSC Recommendation: The FSC recommends the Explanatory Memorandum should clarify that the authority conferred on a product provider to deduct fees from a nominated account of the client on behalf of a fee recipient pursuant to a mere direct debit arrangement does not constitute 'control' of the account for the purposes of the proposed third party consent mechanism.

4.3 Fee disclosure

4.3.1 Duplication of fee disclosure

The ED as proposed could result in multiple forms of fee disclosure that could work to confuse consumers and prove costly in the provision of financial advice. FDSs will need to provide:

(a) a forward-look as to the fees a client can expect to be charged and the services a client will receive in the 12 months immediately after the OFA is entered into; and
(b) a summary of fees charged and services provided over the past year.[2]

Commentary on the issues relating to the existing disclosure regime have been well canvassed in a joint report from ASIC and the Dutch Financial Markets Authority last year[3]. While this report looked at potential gaps in the existing disclosure regime, incoming changes to fee disclosure rules should not have the effect of creating an obligation to disclose fees in duplicate, and where possible simplify fee disclosure.

4.4 Reasonableness test for estimation of fees

Clause 1.24 of the Explanatory Memorandum states[4]:

> *"where the amount of an ongoing fee cannot be determined, the fee disclosure statement must include a **reasonable estimate** of the fees and an explanation of the method used to work out the estimate. These amendments will supplement, not replace, the existing fee disclosure statement regime"*

A client's circumstances can change considerably during the year. The process of informing clients what their fees might be can be complex. The parameters of what constitutes reasonableness in an environment where there are higher compliance requirements and breach reporting obligations being introduced should be clarified. As proposed, an FDS breach is subject to civil penalty provisions and there is a breach of a core obligation and therefore a reportable situation.

While the intention of this provision is to ensure the full provision of and complete information to clients, it could be counterproductive to the goal of ensuring clients have clear

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[2] Page 8, Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919m-explanatory-memorandum-rec2_1-final.pdf
[3] ASIC. *REP 632: 'Disclosure: Why it shouldn't be the default:'* https://download.asic.gov.au/media/5303322/rep632-published-14-october-2019.pdf
[4] Page 9, Explanatory Memorandum, Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919m-explanatory-memorandum-rec2_1-final.pdf

expectations about what this means. Many clients will engage a financial adviser to navigate what is an already a complex financial services environment. The parameters of the advice providers responsibility in that regard should be clear. Guidance from ASIC on what it considers to be a "reasonable estimate" is required for and further guidance in the EM to ensure that an inaccurate estimate does not end an OFA.

4.4.1 Clarification sought on the estimation of asset-based fees

The FSC welcomes clarification that disclosure of asset-based fees could be made based upon an assumption that the value of assets remains consistent through the next 12 months.

4.5 Transitional timeframes

As currently drafted, the proposed legislation considers two separate transitional arrangements that apply to existing arrangements in force prior to 1 July 2020, requiring advisers to give clients a renewal notice and fee disclosure statement and consent to deductions of advice fees prior to:

- 1 January 2021 for arrangements entered into prior to 1 July 2013
- 1 July 2021 for all other existing arrangements

It is not immediately clear why a shorter six-month timeframe has been proposed for pre-FOFA arrangements which do not currently require advisers to adhere to the existing OFA requirements. As these same transitional timeframes apply in relation to recommendations 3.2 and 3.3 this poses additional challenges in that trustees, and product providers more broadly, will not necessarily know which type of arrangement an individual is subject to, making it difficult to be satisfied as to whether an existing arrangement is permitted to continue. This may force product providers to only offer a shorter transitional timeframe in order to meet their obligations.

The alignment of transitional timeframes that apply to existing arrangements would promote consistency across the industry and allow advisers sufficient time to meet with all impacted clients to renew their arrangements where necessary.

FSC Recommendation: The FSC recommends a 12-month transitional timeframe is applied to all existing arrangements entered into prior to the commencement date.
FSC Recommendation: The FSC recommends the commencement giving effect to this provision of the legislation be 1 January 2021.

4.6 Definitions

Some clarity around core definitions could be looked at as the legislation is finalised.

For the purposes of Sections 962R, 962S and 962U the term "*account*" is not defined. It should be clear whether the intention of these sections is to capture "*bank accounts*". The term of "*account provider*" could be more clearly defined. It is unclear whether this relates to the financial institution that the account is held with or could it be a product issuer (such as an IPDS operator or superannuation fund trustee).

FSC Recommendation: "Account" should be defined, clarity as to whether this captures "bank accounts" and a clearer definition of "account provider" allowed for the purposes of Sections 962R, 962S, and 962U.

4.7 Materiality in relation to civil penalties

A breach of Section 962X constitutes a criminal offence under ED.

The FSC notes that failure to keep appropriate records is intended to constitute a criminal offence with a penalty of up to one-year imprisonment. The FSC feels strongly that consideration should be given as to whether this an appropriate penalty for isolated or immaterial record keeping due to omissions.

A materiality threshold to determine breach of this section or the applicability of the penalties provision should be considered by Treasury. For example, it would be unreasonable for a licensee to be penalised for a business continuity planning **(BCP)** event.

FSC Recommendation: The FSC advocates for the inclusion of a materiality threshold for isolated or immaterial record keeping errors.

4.8 Provisions for circumstances where a client cannot be contacted

The ED does not contemplate a situation where a client cannot be contacted to commence the renewal process. This might occur in situations where a client is absent from their usual residence or uncontactable or is unwell. A provision addressing this possibility would ensure advisers do not fall into technical breach of the law. An allowance for such circumstances,

(a) would not require a change in the renewal date
(b) would prevent the possibility of an agreement being terminated unnecessarily.

FSC Recommendation: The FSC recommends the legislation be amended to allow a waiver period of up to 90 days for a limited set of circumstances, including where a client cannot be contacted and an OFA is at risk of being terminated as a result.

A "*limited set of circumstances*" will require a definition that does not add complexity to the resulting regulatory regime and aligns with the purpose of this recommendation.

4.9 Scope creep

Requiring agreements to be annually renewed could have an unintended consequence of scope creep. For example, when a client engages their adviser to bring forward annual renewal dates say for example days before the 12 months from when the date the arrangement commences. This might require review over time if this situation emerges which might have the effect of thwarting the policy intent of this legislation.

An unintended consequence of the ED could be scope creep. Given the timeframes for renewal (30 days from date of renewal) as mentioned above, advisers and clients may be forced to bring forward the consent (earlier than the 12-month renewal date).

This would, under the ED, reset the renewal date and effectively perpetually shorten the arrangement. It would be preferable for advisers and clients to be able to maintain the original renewal date and have a period of time prior to that date (e.g. 30-60 days) during which future annual consent would be provided in anticipation of that original annual date. This level of flexibility would maintain the intent of the annual arrangements contemplated under the legislation.

4.10 Commencement

Significant updates to the compliance systems of advice businesses will be necessary to properly implement Recommendation 2.1 of the FSRC. The next year brings with it developments such as the elimination of grandfathered conflicted remuneration and the adoption of new professional standards and education requirements. Reasonable time afforded under the legislation to enable advice businesses to be fully compliant with the law would be welcomed.

FSC Recommendation: That the legislative provisions implementing FSRC Recommendation 2.1 commence one year from Royal Assent.

5. Provisions implementing - FSRC Recommendation 2.2

Recommendation 2.2 proposes amendments to the Corporations Act to require[5] a providing entity (a financial services licensee or authorised representative) who is not independent, impartial or unbiased, to give a written disclosure to a retail client to whom they providing personal advice, of the lack of independence (in a form prescribed by ASIC).

The ED proposes to require financial services licensees to include such disclosure in its Financial Services Guide to be provided to retail clients and suggests that ASIC may prescribe the form of this language.

The FSC supports the proposed reforms and in this section offers minor or technical changes to improve its effectiveness.

5.1 ASIC's role

The proposed legislation establishes ASIC's role in prescribing how written disclosure of a lack of independence[6] should be made including the form of words, information, presentation and structure.

The FSC welcomes the prescription as to ASIC's role relating to independence disclosure statements. It is possible that this might require further clarification over time. The proposed legislation does not change the definition of independence and it is likely further clarification will be required to ensure that the concepts of 'independent', 'impartial' and 'unbiased' are clear and aligned with existing legal definitions and regulatory guidance for interpretation. Such terms it can be assumed will be interpreted with reference to their ordinary meaning; however for the purposes of the proposed legislation this should be defined. Consideration should also be given to the effect the amendments will have on small businesses in comparison with larger organisations, in particular, the level of costs to be incurred in relation to the update of compliance systems and processes.

5.2 Commencement

FSC Recommendation: The FSC recommends the legislation implementing FSRC Recommendation 2.2 commence one year from Royal Assent.

[5] Page 3, Explanatory Memorandum, Australian Government The Treasury: https://treasury.gov.au/sites/default/files/2020-01/c2020-48919m-explanatory-memorandum-rec2_2-final.pdf
[6] Ibid.

6. Need to avoid conflicting regulation

As a general observation, this ED is being introduced in the context of several regulatory changes across the advice community. Some changes are subject to ongoing consultation, and some, changes have not yet occurred, such as the introduction scheduled later this year of a single disciplinary body. This disciplinary body will likely assess advice providers against FASEA's Guidance on the Code of Ethics and other applicable legislation and regulation.

In some instances, FASEA's Guidance **(the Guidance)** on the Code of Ethics reflects higher requirements than those imposed by legislation, and this will have implications for the decisions made by the disciplinary body including informing the way legislation is interpreted. The Guidance sets out how conflicts should be managed and assessed. It too remains the subject of ongoing consultation. Even where such requirements reflect standards higher than the law, as such guidance does, these instruments ultimately inform the decisions advice providers make in how they apply the law. Such an example might be when making determinations about how a reportable situation arises as required under the proposed legislation to strengthen existing breach reporting obligations.

The interaction between the FSRC 2.2 (disclosure of lack of independence) and standard 3 of the Code of Ethics (prohibiting an adviser to advise, refer or act for a client in the event of a conflict of interest or duty) should also be clarified.

To avoid providing a client with another disclosure document the disclosure of lack of independence can be included in the Financial Services Guide.

7. Conclusion

The FSC confirms the support of its members to implement the recommendations of the FSRC.

The changes put forward in this submission are intended to help ensure an orderly and effective implementation of the FSRC's recommendations which are in the interests of Australian consumers, financial services regulators and financial services licensees.

The FSC welcomes further opportunities to assist Treasury to achieve this in advance of progressed drafts being introduced to the Parliament later this year.