Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Key Reforms in the Regulation of Financial Advice

Background Paper 8

This paper was prepared by the Treasury in response to a request made by the Royal Commission.

Australian Government

The Treasury

FINANCIAL SERVICES ROYAL COMMISSION

KEY REFORMS IN THE REGULATION OF FINANCIAL ADVICE

OVERVIEW OF KEY REFORMS IN THE REGULATION OF FINANCIAL ADVICE

Financial advice can play an important role for consumers: access to affordable, quality financial advice can bring significant benefits to consumers and help them to make informed decisions by providing guidance with financial planning, insurance and product recommendations.

At the request of the Commission, this information note focuses on the following significant reforms affecting the regulation of financial advice since 2007:

- Future of Financial Advice (FOFA) reforms;
- life insurance remuneration reforms;
- establishment of a Financial Advisers Register; and
- development of professional standards for financial advisers.[1]

A list of ASIC regulatory guidance and legislative instruments issued or updated since 2007 that relate to financial advice is also included in **Attachment A.** This Information note does not consider the overall regulation of the provision of financial information and financial advice or the reforms relevant to all financial service providers.

The reforms since 2007 have been aimed at addressing a number of barriers to quality financial advice through better aligning incentives of financial advisers with consumers, increasing transparency about financial advisers' credentials and enhancing minimum education and training standards in the sector.

A key challenge in regulating the financial services sector is to find the right balance between consumer protection and ensuring that consumers have access to affordable financial advice. It is estimated that 20 to 40 per cent of consumers in Australia access the services of a financial adviser or planner, with 48 per cent of Australian adults indicating unmet advice needs.[2] Amongst the barriers to accessing financial advice is the high cost of advice and lack of funds to pay for advice. Estimates of the average cost of financial advice range from $1,250 for scaled advice to $2,500 for comprehensive advice. In contrast, Australian adults

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1 The *Corporations Amendment (Professional Standards of Financial Advisers) Bill 2016* made amendments to the *Corporations Act 2001* to raise the education, training and ethical standards of financial advisers; these are referred to as 'professional standards' for the purposes of this information note.

2 Productivity Commission, Draft Report: Competition in the Australian Financial System, January 2018, 355, https://www.pc.gov.au/inquiries/current/financial-system/draft/financial-system-draft.pdf.

were only willing to pay, on average, $780 to receive financial advice.[3] Accessibility, therefore, remains an important consideration in any reform.

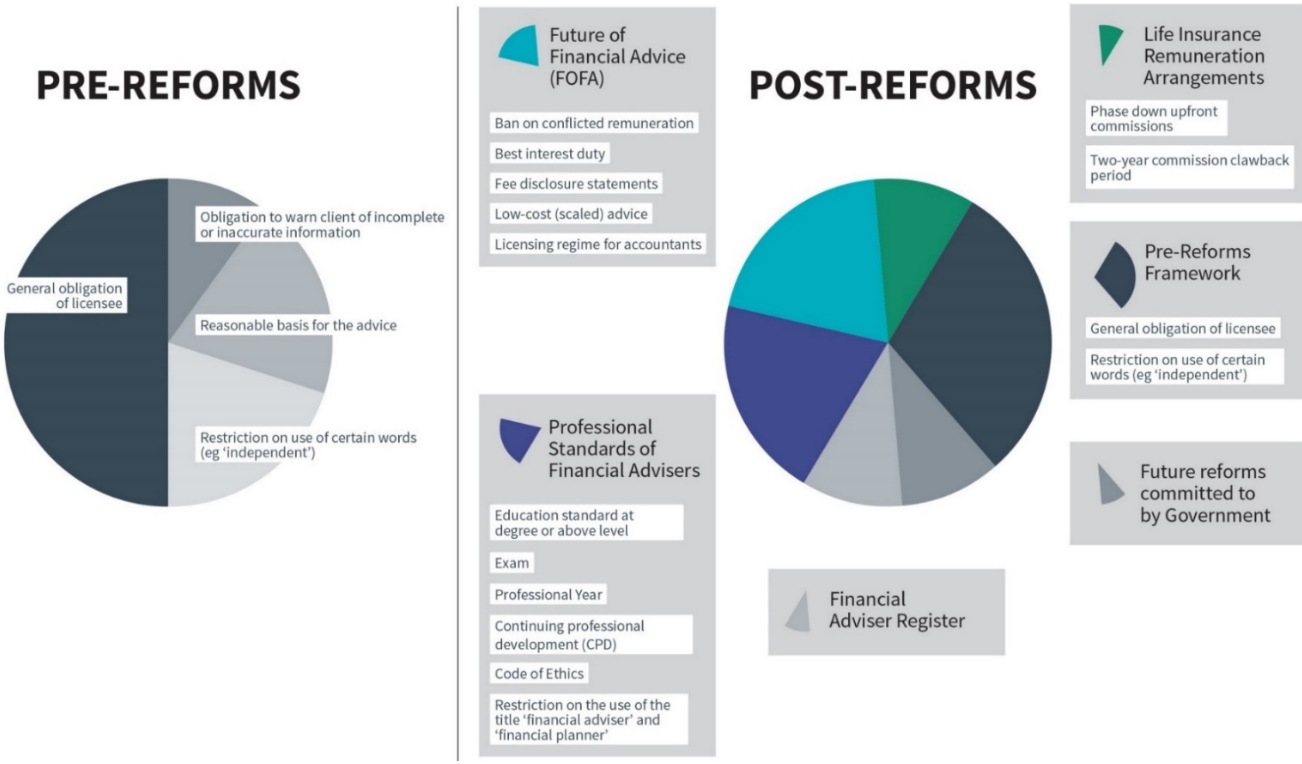
The Government has committed to further reforms in financial advice regulation. These include a number of recommendations from the 2014 Financial System Inquiry,[4] including to strengthen ASIC's enforcement tools in relation to the financial services and credit licensing regimes, to ban individuals from management within financial firms from operating in the industry, to rename 'general advice' to improve consumer understanding, and to improve guidance and disclosure in general insurance.

Cumulatively, these reforms (including the further reforms committed to by Government) have seen a significant shift in the regulation of financial advice (compared with the framework before FOFA) with more reliance on a range of regulatory levers rather than just the general licensing framework. Recent reforms also represent a move away from reliance on disclosure to a more interventionist approach. These shifts are illustrated in the infographic below. As a number of these reforms will commence over coming years, the full impact of the reforms cannot yet be assessed.

3 Ibid.

4 The Commonwealth of Australia, Financial System Inquiry – Final Report, November 2014, http://fsi.gov.au/publications/final-report/

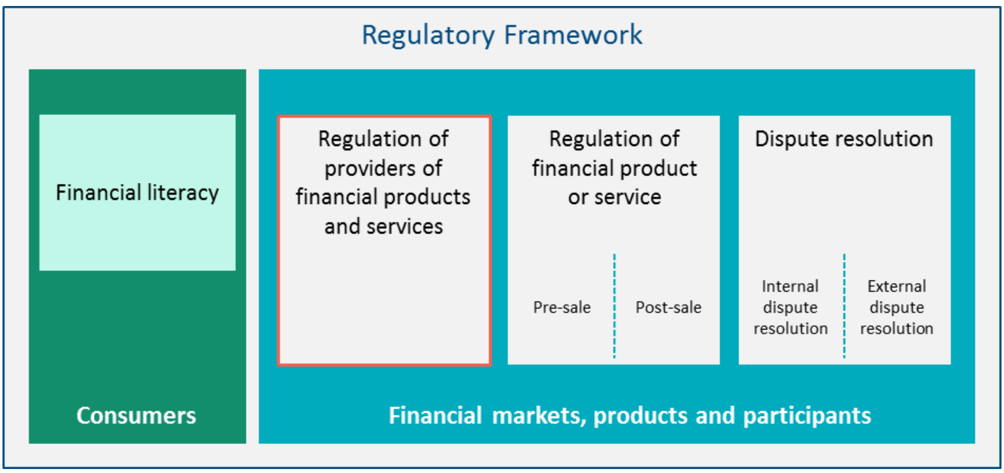
Regulation of financial advice



This diagram is for illustrative purposes only. The proportions are not necessarily representative of the actual, or relative, significance of each reform.

Ultimately, supporting good consumer outcomes in the regulation of financial advice requires taking a system wide perspective (illustrated in the infographic below) which includes:

- building consumer confidence and consumers' capacity to understand financial advice (for example, financial literacy initiatives, such as ASIC's Moneysmart program and funding provided to ensure teachers have the resources to deliver financial literacy programs in school);
- regulating the providers of financial advice (a number of reforms are discussed in this Information note);
- regulating the financial services and products provided. (In addition to general product disclosure requirements, and product-specific regimes like the responsible lending, margin lending and MySuper regimes, the Government has committed to obligations requiring issuers to identify appropriate target markets for their financial products, requiring distribution practices to be aligned with the target markets identified, and to provide ASIC with a Product Intervention Power); and
- providing adequate access to redress (this includes internal and external dispute resolution, such as the reforms to establish the Australian Financial Complaints Authority, the new one-stop shop dispute resolution body).



FUTURE OF FINANCIAL ADVICE REFORMS

BACKGROUND

A number of financial product and services providers collapsed in the wake of the Global Financial Crisis.[5] These collapses left many investors, particularly those who had borrowed to invest, with great challenges in repaying their debts, meeting living expenses and, in some cases, keeping their homes. In the past 10 years, over 80,000 consumers have been affected, with losses totalling more than $5 billion, or $4 billion after compensation and liquidator recoveries.[6]

In response to the corporate collapses, the Parliamentary Joint Committee on Corporations and Financial Services conducted an inquiry into financial products and services in Australia. The report, known as the Ripoll Report (after the Chair of the Inquiry, Bernie Ripoll MP) was released in November 2009 and identified conflicted remuneration as the leading cause of poor financial advice provided to clients.

The Ripoll Report made 11 recommendations that were designed to enhance professionalism in the financial advice sector and enhance consumer confidence and protection. The key recommendations were:

- the introduction of a statutory fiduciary duty for financial advisers requiring them to place a client's interest ahead of their own (Recommendation 1); and
- that the Government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers (Recommendation 4).

The FOFA reforms were developed to address the recommendations of the Ripoll Report. The FOFA reforms were aimed at improving the quality of financial advice provided to retail consumers of financial services through reducing conflicts of interests by better aligning the interests of the financial advisers and consumers. As well as applying to financial advisers, they apply to all Australian Financial Service licensees, representatives who give financial product advice to retail clients (including front-line bank staff, call centre staff and robo-advice providers).

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5 Collapses include Storm Financial, Opes Prime, Westpoint and Banksia Securities.

6 Commonwealth of Australia 2014, *Financial System Inquiry Final Report*, page 28.

LEGISLATION

The FOFA legislation was introduced by the Corporations Amendment (Future of Financial Advice) Act 2012 and the Corporations Amendment (Further Future of Financial Advice Measures) Act 2012 (the FOFA Bills). The legislation took effect from 1 July 2012, with compliance becoming mandatory from 1 July 2013.

The main components of the FOFA Bills included:

- a ‘best interests’ obligation that requires financial advisers to act in the best interests of their clients when giving personal advice;
- a ban on conflicted remuneration (including commissions, volume payments and soft-dollar benefits) when financial product advice is provided to retail clients; and
- increased transparency through a requirement that providers of financial advice obtain client agreement to ongoing advice fees, and enhanced disclosure of fees and the services associated with ongoing fees.

Changes were also made at this time to allow superannuation funds to charge collectively across their membership for the provision of simple, non-ongoing personal advice to members ('intra-fund advice').

In 2014 and 2015, the *Corporations Amendment (Revising Future of Financial Advice) Regulation 2014* and *Corporations Amendment (Financial Advice) Regulation 2015* were made to clarify aspects of FOFA. These Regulations commenced on 16 December 2014 and 1 July 2015 respectively. There were also several other regulations made to provide additional exemptions (for example, for time-share arrangements).

In November 2015, Parliament passed the *Corporations Amendment (Financial Advice Measures) Bill 2015* which made a number of further amendments to clarify the operation of FOFA. The amendments, which commenced on 19 March 2016, also introduced a limited regulation-making power to allow the Government to wind back existing exemptions to conflicted remuneration to address any future unintended consequences in relation to the conflicted remuneration provisions.

CONSULTATION

Recognising the significance of the reforms, there was extensive consultation with stakeholders through submissions, consultation groups, public information sessions, consultation papers and meetings.

While there was a broad recognition across stakeholders that reform was required, the reach of the reforms was highly contested. For example, there were divergent views regarding how far a new statutory best interests duty would go, the need for greater disclosure of fee information and how the removal of product-related remuneration would impact on the affordability of financial advice. This last concern is reflected, for example, in the legislation expanding access to scaled advice, that is, personal advice that is limited in scope, also recognising consumers’ preference for piece-by-piece advice rather than comprehensive advice.

For example, as part of implementing the reforms in 2012, targeted consultations were conducted with the Association of Financial Advisers, the Association of Independently Owned Financial Professionals, the Australian Bankers' Association, Choice, the Financial Planning Association, Financial Services Council, Industry Super Australia, the Property Council of Australia and the major wealth management companies. This was referred to as the 'Peak Consultation Group' and meetings occurred on a monthly basis for 12 months leading up to the development of draft legislation.

Further consultation occurred in 2012 when the FOFA Bills were referred to the Parliamentary Joint Committee for Corporations and Financial Services for inquiry and report.

KEY ASPECTS OF THE REFORMS

BEST INTERESTS DUTY

The reforms introduced a 'best interests' duty — a statutory duty requiring persons who provide personal financial advice to act in the best interests of their clients. Prior to that, there were no provisions in the *Corporations Act 2001* (Corporations Act) that required a financial adviser to act in the best interests of the client or to give priority to the interests of the client when providing advice. That meant that as long as the advice met the standard of being appropriate and the necessary disclosures had been made, the adviser was not prohibited by the Act from giving advice that benefits the adviser rather than, and in preference to, the client.

The reforms were aimed at ensuring that financial advisers acted in a way that was consistent with the client's best interests. The principle guiding the application of the best interests obligation is that meeting the objectives, financial situation and needs of the client must be the paramount consideration when providing advice.

One way in which an adviser can demonstrate they have complied with the best interest duty is to take the steps outlined in the legislation, which act as a 'safe harbour' for complying with the best interests duty. These steps require the adviser to:

- identify the objectives, financial situation and needs of the client that were disclosed by the client through instructions;
- identify the subject matter of the advice, the objectives, financial situation and needs of the client that are reasonably relevant to the advice sought;
- make reasonable enquiries to obtain complete and accurate information, where it was reasonably apparent that information was incomplete or inaccurate;
- conduct a reasonable investigation into the financial products that might achieve the client's needs if it would be reasonable to consider recommending a financial product; and
- base all judgements on the client's relevant circumstances.

Advisers must also take any other reasonable steps if it would have been in the best interests of the client to do so at the time the advice was given.

The best interests duty is based on the notion of 'reasonableness'. Advisers are required to make reasonable inquiries to obtain accurate information from the client and conduct a reasonable investigation into relevant financial products. This is designed to protect advisers from clients claiming that the adviser should have done something onerous or unreasonable in order to act in their best interests.

A modified best interests duty applies for basic banking products and general insurance products. This modified best interests duty only applies for basic banking products if the advice is given by a person who is an authorised deposit-taking institution (ADI) agent employee, or otherwise acting by arrangement with the ADI under the name of the ADI. Providers of personal advice on these products will be taken to have satisfied the best interests duty if they have:

- identified the objectives, financial situation and needs of the client that were disclosed by the client through instructions;
- identified the subject matter of the advice, the objectives, financial situation and needs of the client that are reasonably relevant to the advice sought; and
- made reasonable enquiries to obtain complete and accurate information, where it was reasonably apparent that information was incomplete or inaccurate.

The rationale for the modified best interests duty for basic banking products and general insurance products was based on the relatively simple nature of these products and the lack of any significant evidence of consumer harm.

The ban on conflicted remuneration

Traditionally, financial advisers were remunerated differently from other professional occupations in that they receive remuneration from sources other than the end-client (that is, commissions). Concerns that commissions increased an adviser's incentive to recommend products, regardless of the client's best interests, underpinned the ban on conflicted remuneration, which applied to both general advice and personal financial advice.

The conflicted remuneration changes were aimed at creating a market-based incentive for advisers to act in the interests of their clients by ensuring an adviser's main source of remuneration was from clients, rather than from third parties (such as product manufacturers). In this way, the ban on conflicted remuneration was intended to complement the best interests duty.

The conflicted remuneration provisions ban all payments that could reasonably be expected to influence advice provided. This includes third-party commission payments (which are usually from a product manufacturer to an adviser to induce the adviser to recommend the product manufacturer's products), soft-dollar benefits (which are non-monetary benefits, for example a holiday or wide-screen TV) and employee performance bonuses.

There were a number of exemptions from the conflicted remuneration provisions, such as for life insurance commissions outside superannuation (reforms passed in 2017 addressed remuneration structures in relation to life insurance and are discussed later in this note), basic banking products and benefits related to a number of stockbroking activities.

The changes included grandfathering provisions to facilitate a smooth transition to the new regime for industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable.

Enhanced fee disclosure and two-yearly fee renewal opt-in arrangements

Prior to the introduction of these changes, a typical fee arrangement in the sector was for a financial adviser to charge a client an ongoing percentage based-fee each period regardless of the level of service provided to a client. This fee arrangement meant that in many cases clients did not know how much they were being charged by their financial advisers. In situations where the client was disengaged, they could have been charged fees even where little or no service had been provided.

The 'best interests duty' and ban on conflicted remuneration is intended to make the consumer the primary source of an adviser's remuneration. Enhanced fee disclosure and opt-in arrangements therefore complemented these reforms by increasing transparency of fees and providing an easy mechanism for consumers to stop paying fees where they do not perceive value for services provided.

The fee disclosure provisions apply to ongoing fee arrangements (where a retail client is given personal advice and charged an ongoing fee during a period of more than 12 months). The rules require advisers who have an ongoing fee arrangement to give new and existing retail clients an annual fee disclosure statement (FDS) which shows the fees paid by the client, the services the client received, and the services the client was entitled to receive, in the previous 12 months.

Under the opt-in provisions, advisers who have an ongoing fee arrangement need to obtain their client's agreement at least every two years to continue the arrangement. The adviser must send a renewal notice to their client within 60 days of the end of the two-year period and the client must, within 30 days of the adviser giving them the renewal notice, agree to renew the ongoing fee arrangement for it to continue. Opt-in requirements only apply to new clients from the licensee's application day onwards, which is 1 July 2013 in most cases.

ASIC has the power to exempt financial advisers from this opt-in arrangement if that adviser is bound by an ASIC-approved code of conduct that obviates the need for advisers to comply with the opt-in requirement. The only code of this type currently approved by ASIC is the code of conduct for the Financial Planning Association of Australia (FPA). It is not clear how many advisers have subscribed to this code.

REVIEWS FOLLOWING FOFA

ASIC has undertaken a number of reviews that have examined the behaviours and practices of financial advisers since the introduction of the FOFA reforms. This has included changes in product offerings, as well as changes in revenue sources.

The reviews include:

- ASIC's Report 407 – *Review of the financial advice industry's implementation of the FOFA reforms*, released in September 2017.
- ASIC's Report 562- *Financial advice: Vertically integrated institutions and conflicts of interest*, released in January 2018.

LIFE INSURANCE REMUNERATION REFORMS

BACKGROUND

Under the original FOFA reforms, benefits paid in relation to life risk insurance outside of superannuation were exempted from the ban on conflicted remuneration.

Following the FOFA reforms, various inquiries into the life insurance sector identified that the remuneration arrangements for life insurance advisers were resulting in a misalignment of interests between advisers and consumers.

In its October 2014 *Report 413 – Review of Retail Life Insurance Advice*, ASIC found that that 82 per cent of life insurance advisers were remunerated under an upfront commission model. Under the upfront commission model advisers received an upfront commission of 100 to 130 per cent of the new business premium and an ongoing commission of around 10 per cent of renewal premium.

ASIC found that in 37 per cent of cases, the advice that was provided failed to meet the minimum legal standard and that there was a strong correlation between the upfront commission model and poor advice – where an adviser was paid under an upfront commission model, 45 per cent of advice failed to meet the minimum standard and where the adviser was paid under another commission structure, the fail rate was 7 per cent.

The evidence presented in ASIC's report demonstrated that the upfront commission structure created an incentive for advisers to unnecessarily replace consumers' existing life insurance policies (commonly known as churn), a practice that was causing consumer harm.

Subsequently, industry commissioned the Review of Retail Life Insurance Advice chaired by John Trowbridge. The resulting report (the Trowbridge report) acknowledged the issues and recommendations in the ASIC review and made further recommendations designed to improve consumer outcomes, including a significant, though highly contested, modification to the upfront commission model.

The findings from the ASIC and Trowbridge reviews were further considered in the Financial System Inquiry. The Inquiry made recommendations to ensure that remuneration structures in life insurance do not affect the quality of financial advice, recommending the introduction of a level commission structure so that any upfront commission does not exceed ongoing commissions. Government accepted the recommendation of the Financial System Inquiry.

OBJECTIVES OF THE LIFE INSURANCE REMUNERATION REFORMS

The life insurance remuneration reforms were specifically targeted at reducing advisers' incentives to engage in unnecessary product replacement. By reducing the incentive to churn clients through products, the reforms are intended to provide a better basis for advisers to give advice that is more appropriate to consumer needs. They comprise of two key components:

- introducing a cap on upfront commissions equal to 60 per cent of the initial premium and a 20 per cent cap on ongoing commissions; and
- introducing a clawback requirement, under which a portion of the upfront commission is repaid to the insurer if the life insurance product lapses in the first two years (100 per cent in the first year and 60 per cent in the second year). Clawback arrangements also apply where a policy is still held, but is reduced in the first two years.

The reforms did not limit the ability of insurers to pay level commissions or for advisers to directly charge consumers advice fees.

While the reforms were designed to align better the interests of consumers and advisers, they also needed to ensure continued access to quality, affordance advice to support purchasing decisions by maintaining business viability and had to balance concerns about the level of underinsurance in the Australian community.

The key elements of the framework that were designed to promote ongoing business viability and address concerns about underinsurance were:

- maintaining the ability to pay commissions for advice on life insurance - for most types of financial advice apart from life insurance, it is possible to charge asset based fees as there are investible funds. However, this is not possible in the case of life insurance, as there are no investible funds. Given that some consumers will be reluctant to seek advice if they were required to pay for it up front, the outright ban on conflicted remuneration does not apply to advice on life insurance products;[7]
- allowing upfront commissions that are higher than ongoing commissions – the upfront commission model reflects the costs that businesses incur when providing advice, which tend to be incurred upfront when the advice is initially provided. While upfront commissions have been significantly reduced through the reforms, they still better match the costs business face relative to a level commission structure.

LEGISLATION

The *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* legislated to:

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7 This assessment was consistent with the findings of the Financial System Inquiry (p. 220).

- remove the exemption for life insurance from the ban on conflicted remuneration (introduced under the FOFA reforms);
- allow for level commissions to be paid;
- provide ASIC with the power to set caps on the maximum commission that can be paid, with the relevant caps set by ASIC through a legislative instrument;[8] and
- introduce two-year commission clawback arrangements (from 1 January 2018).

The reforms apply to both personal and general financial advice. The reforms were extended to direct sales (where often no advice is provided) by prohibiting certain benefits paid in relation to information given to a person in relation to a life insurance product.

The reforms commenced from 1 January 2018 and ASIC will have responsibility for reviewing the effect of the reforms in 2021.

Stakeholders were consulted throughout the policy development process. An industry led process resulted in the development of the final reform package. Industry roundtables were also held following the release of the draft legislation with the Financial Services Council, the Association of Financial Advisers and the Financial Planning Association.

FINANCIAL ADVISERS REGISTER

BACKGROUND

Several parliamentary inquiries recommended, or endorsed, the establishment of a public register of financial advisers. These include the 2013 Senate Economic References Committee's Inquiry into the performance of the ASIC, the 2012 Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the collapse of Trio Capital and the 2014 Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into proposals to lift the professional, ethical and educational standards in the financial system industry (PJC Inquiry).

These inquiries pointed to the lack of readily-accessible information about financial advisers' credentials available to the public. This information gap meant that consumers could not easily check their adviser's credentials.

OBJECTIVES OF THE REGISTER

There was broad support for Government to implement the register. The primary objective of the Register was to improve transparency and empower consumers to validate and choose their financial advisers. Providing accurate and relevant information on all advisers

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8 ASIC subsequently issued a legislative instrument which set the maximum commission cap at 80 per cent of the initial premium upfront from 1 January 2018, phasing down to 60 upfront from 1 January 2020 and 20 per cent of the ongoing premium from 1 January 2018.

in an easily accessible form empowers consumers to understand from whom they were getting advice. Empowering consumers may be an effective way of achieving desired regulatory outcomes and complement other reforms, such as the reforms to lift adviser standards and improving professionalism.

The register also assists ASIC in its compliance activities by allow them to identify, track and monitory all financial advisers.

LEGISLATION AND CONSULTATION

In 2014, the Government decided that ASIC should establish and maintain the Register.

In July 2014, the Government established the Australian Financial Services Licence Industry Working Group (the Working Group) to provide advice to the Government on a number of implementation issues concerning the Register of Financial Advisers. The Working Group included representatives from the accounting, financial advising, financial services, funds management, insurance broking, banking, stockbroking and superannuation industries, as well as consumer and academic representatives, ASIC and Treasury. The Register was fundamentally informed by the recommendations of the Working Group. Stakeholders were also extensively consulted on the draft legislation and regulations to implement the Register.

Legislation to establish the register was introduced on 12 February 2015.

KEY ELEMENTS OF THE REFORM

1. The Register became functional on 31 March 2015. The register enables investors, employers and ASIC to check the credentials of financial advisers and be confident that they are appropriately qualified and experienced.

The Register includes:

- the adviser's name, registration number, status, and experience;
- the adviser’s educational qualifications and professional association memberships;
- the adviser's licensee (and, if applicable, authorised representative), previous licensees/authorised representatives and business name;
- what product areas the adviser can provide advice on;
- any bans, disqualifications or enforceable undertakings;
- if applicable, each person who controls the adviser’s licensee; and
- if applicable, a link from any ABN of the licensee, authorised representative or adviser to the business names associated with those ABNS on the Australian Business Register.

Enhancements to the Register

As part of the Professional Standards reforms, several new information fields are to be added to the Register. The enhancements to the Register and the reforms to increase the standards of financial advisers were recommendations of both the Financial System Inquiry and the PJC Inquiry.

These include:

- information about whether an adviser is a ‘provisional financial adviser’ who is still completing their professional year and is subject to supervision requirements;
- the adviser's principal place of business;
- information about whether the adviser has failed to comply with new CPD requirements set by the standards body;
- the name of the compliance scheme which applies to the financial adviser (the ASIC-approved compliance scheme will monitor and enforce the Code of Ethics); and
- details about whether the adviser has breached the Code of Ethics set by the standards body and any sanctions imposed.

PROFESSIONAL STANDARDS OF FINANCIAL ADVISERS

BACKGROUND

Prior to the introduction of these reforms, the financial services industry, consumer groups, and ASIC raised concerns about the education and training requirements applicable to financial advisers. Standards were considered to be too low, contributing to a lack of confidence in the competency and conduct of advisers.

The PJC Inquiry and the Financial System Inquiry identified that the existing professional standards for financial advisers were too low and did not ensure that all advisers had the skills to provide high quality advice. These reviews recognised that the existing regulatory framework was insufficient to generate consumer confidence in the industry, discouraged professionalisation and did not encourage industry to take a greater lead in lifting standards.

In addition, the framework for financial advisers did not have an exam to provide a common benchmark across the industry, specific requirements for monitoring and supervising new advisers to enable the adviser to develop the requisite minimum skills to provide sound financial advice, or require financial advisers to subscribe to a code of ethics.

OBJECTIVES OF PROFESSIONAL STANDARDS

In response to both the PJC Inquiry and Financial System Inquiry, on 20 October 2015, the Government announced that it was committed to ensuring that consumers receive professional and fair treatment from advisers.

The Government announced that it would raise the education, training and ethical standards of financial advisers to improve consumer trust and confidence in the financial services sector. Professional standards were intended to increase the likelihood of consumers receiving customer-focused quality advice and to facilitate consumer access to information about financial advisers' experience and qualifications to improve transparency and competition.

LEGISLATION

The *Corporations Amendment (Professional Standards of Financial Advisers) Act 2017* introduced several measures in the Corporations Act including:

- requiring new financial advisers to have a degree, have to pass an exam and undertake a professional year to be authorised to provide unsupervised personal advice to a retail client;
- requiring existing advisers to bring their qualifications up to degree or equivalent level, through bridging courses or other education-based programs determined by the standards body and pass an exam;
- requiring all advisers both new and existing to undertake continuing professional development (CPD) and be party to a code of ethics monitored by an ASIC approved compliance scheme;
- requiring Australian financial services licensees to ensure that their financial advisers comply with the new education standards;
- restricting the use of the terms 'financial adviser', 'financial planner' and other similar titles to those who meet the above minimum standards;
- enhancing the ASIC maintained register of financial advisers to increase transparency around advisers' education qualifications, their principal place of business and membership of a relevant compliance scheme monitoring their ethical behaviour; and
- the provision of relevant sanctions where a financial adviser or licensee fails to comply with the new obligations.

The new education, exam, professional year and CPD requirements apply from 1 January 2019 for new financial advisers. Existing advisers will have until 1 January 2021 to pass the exam and 1 January 2024 to meet the degree equivalent requirement. The provisions relating to the Code of Ethics take effect from 1 January 2020.

FINANCIAL ADVISERS STANDARDS AND ETHICS AUTHORITY

In April 2017, the Government established the Financial Advisers Standards and Ethics Authority (FASEA) to set the education, training and ethical standards of financial advisers.

FASEA is responsible for developing and setting the industry exam, developing the code of ethics, and setting the education requirements.

Careful consideration was given to the structure and constitution of FASEA. Following public consultation, the Government decided that a Commonwealth company limited by guarantee was preferred over other potential structures (such as an industry run body with oversight from Government) for the following reasons:

- a Commonwealth body was seen as more likely to restore confidence in the financial services industry than an industry body.
- a Commonwealth company was perceived as being less at risk than an industry body of being unduly influenced by larger industry stakeholders that would have greater resources than consumer groups and independent financial adviser representatives.

FASEA's standard setting function is independent of Government. FASEA is governed by a board whose composition is prescribed in legislation. The legislation requires the Board to be comprised of nine directors (including the Chair), with at least:

- three directors with experience in operating a financial services business or providing a financial service;
- three directors with experience in representing consumers in relation to financial services;
- one director with practical experience in designing, or the requirements of, educational courses or degrees; and
- one ethicist.

The responsible Minister has the power to appoint directors.

FASEA is funded by industry, recognising that ensuring adequate professional standards is an obligation of industry and it is appropriate for industry to maintain and fund the standard setting body. Structuring the body as a Commonwealth company limited by guarantee could allow for the body to be transferred to industry in the future, once the sector had professionalised sufficiently to perform the role itself.

Release of draft standards

Education Pathways

On 19 March 2018, FASEA released draft guidance on education pathways for existing financial advisers for consultation until 30 June 2018.

FASEA has determined five pathways of education, based on the various current qualifications of advisers, so that advisers can comply with the new statutory requirements by the due date of 1 January 2024.

Under the proposed pathways, existing advisers will need to undertake either a relevant qualification (approved graduate diploma or other degree or masters), or between one and three bridging courses, including a course that focuses on the new Code of Ethics developed by the Standards Authority.

The draft guidance states that:

- a 'related qualification' for the purposes of the guidance is any AQF 7 or above qualification (equivalent to a bachelor degree or higher) that contains a major or specialisation in financial planning, financial advice, financial services, accounting, finance, tax, law or economics;
- advisers with an AQF 7 'related qualification' will have to complete three bridging courses on the Corporations Act (emphasis on Chapter 7), behavioural finance and the Code of Ethics before 1 January 2024 at a Tertiary Education Quality and Standards Agency (TEQSA) approved education provider;
- advisers who hold an AQF 8 or above 'related qualification' (equivalent to a Masters degree or higher), will have to complete a single bridging course on the Code of Ethics before
1 January 2024;
- advisers with an AQF 7 or above qualification that is approved by FASEA will also have to complete a single bridging course on the FASEA Code of Ethics by 1 January 2024; and
- advisers with an unrelated or no qualification will need to complete a FASEA-approved Graduate Diploma, equivalent to eight units of study at an AQF 8 level, by 1 January 2024.

Code of Ethics

On 19 March 2018, FASEA also released the draft Code of Ethics for consultation until 1 June 2018.

The Code of Ethics released by FASEA comprises 12 standards of ethical behaviour, client care, quality process and professional commitment. It has been developed as a principle based model in order to facilitate adoption and alignment with existing regulatory obligations. Every existing adviser will be required to complete a bridging course on the Code as part of the Standard Authority's proposed educational pathways.

FUTURE REFORMS COMMITTED TO BY GOVERNMENT

Arising from the Financial System Inquiry, the Government has committed to the following further reforms relevant to the regulation of financial advisers:

- 'general advice' should be renamed to improve consumer understanding (Recommendation 40);
- financial advisers should disclose their ownership structures (Recommendation 40);
- guidance and disclosure in general insurance should be improved (Recommendation 26);
- ASIC should have the power to ban individuals involved in the management within financial firms from operating in the industry (Recommendation 24); and
- ASIC's enforcement tools in relation to the financial services and credit licensing regimes should be strengthened (Recommendation 29) by enabling ASIC to:
  - approve changes of licensee control;
  - consider a broader range of factors in determining whether an applicant satisfies the 'fit and proper' test to be granted a licence; and
  - impose conditions on firms to address concerns about internal systems relating to serious or systemic conduct.

In response to recommendation 29, the Government established the ASIC Enforcement Review Taskforce to review ASIC's enforcement regime. The Taskforce consulted on the following preliminary positions for reform in position and consultation papers:

- For Australian Financial Services licensees self-reporting their breaches, the Taskforce consulted on propositions to clarify reporting obligations, increase accountability for licensees and their representatives or employees, introduce new penalties for non-reporting, require ASIC to publish data on breach reports, and introduce an equivalent reporting regime for credit licensees.
- For ASIC's power to ban individuals in the financial sector, the Taskforce consulted on the proposition to enable ASIC to ban individuals from managing financial services businesses in addition to their current power to ban individuals from providing financial services. The Taskforce also proposed allowing ASIC to ban an individual who is not a fit and proper person to fulfil their role.
- For ASIC's power to refuse, revoke or remove a licence, the Taskforce consulted on the proposition to have a fit and proper test for licensees and their controllers. The Taskforce also proposed creating a statutory obligation to notify ASIC about changes of control in a financial services business and requiring financial service licence applicants to inform ASIC of any material changes to their application.

The Taskforce provided its report to Government in December 2017 and the Government is currently considering the Taskforce's final recommendations.

ATTACHMENT A - ASIC GUIDANCE – FINANCIAL ADVICE

TABLE 1: REGULATORY GUIDANCE

DATE	TITLE
November 2001 - originally issued as guide Licensing: *The scope of the licensing regime: Financial product advice and dealing* Last updated June 2016	RG 36 *Licensing: Financial product advice and dealing*
August 2005 - originally issued as guide *Example Statement of Advice (SOA) for a limited financial advice scenario for a new client* Last updated December 2017	RG 90 *Example Statement of Advice: Scaled advice for a new client*
September 1999 - originally released as *Interim Policy Statement 146* Last updated July 2012	RG 146 *Licensing: Training of financial product advisers*
June 2003 - originally issued as *Policy Statement 175* Last updated November 2017	RG 175 *Licensing: Financial product advisers – Conduct and disclosure*
December 2006 - originally issued as *Policy Statement 182* Last updated December 2017	RG 182 *Dollar disclosure*
February 2005 Last updated March 2013	RG 183 *Approval of financial services sector codes of conduct* Applies to approval of codes more generally but includes a section on approval of codes for the purposes of exemption to the opt-in requirement.
December 2010 Last updated March 2016	RG 221 *Facilitating digital financial services disclosures*

DATE	TITLE
December 2012	RG 244 *Giving information, general advice and scaled advice*
January 2013 Last updated February 2017	RG 245 *Fee disclosure statements*
March 2013 - originally issued as RG 246 *Conflicted remuneration* Last updated December 2017	RG 246 *Conflicted and other banned remuneration*
August 2016	RG 255 *Providing digital financial product advice to retail clients*
September 2016	RG 256 *Client review and remediation conducted by advice licensees*

TABLE 2: LEGISLATIVE INSTRUMENTS

DATE	TITLE
July 2009	Class Order [CO 09/210] *Intra-fund superannuation advice*
December 2011	Class Order [CO 11/1227] *Relief for providers of retirement estimates*
September 2014	Class Order [CO 14/923] *Record-keeping obligations for Australian financial services licensees when giving personal advice*
December 2014	Class Order [CO 14/1262] *Relief for 31 day notice term deposits*
July 2015	ASIC Corporations (Facilitating Electronic Delivery of Financial Services Disclosure) Instrument 2015/647
August 2015	ASIC Corporations (Advertising by Product Issuers) Instrument 2015/539 (Followed the sunsetting of Class Order [CO 05/835] *General advice in advertising)*
June 2015	ASIC Corporations (General Advice Warning) Instrument 2015/540 (Followed the sunsetting of Class Order [CO 05/1195] *Simplified warning for oral general advice)*
March 2016	ASIC Corporations (Non-cash Payment Facilities) Instrument 2016/211 (Followed the sunsetting of Class Order [CO 02/1075] *Travellers' cheques and confirmation of transactions)*
March 2016	ASIC Corporations (Generic Calculators) Instrument 2016/207 (Followed the sunsetting of Class Order [CO 05/1122] *Relief for providers of generic calculators)*
June 2016	ASIC Corporations (Financial Product Advice—Exempt Documents) Instrument 2016/356 (Followed the sunsetting of [CO 03/606] *Financial product advice — exempt documents*)
August 2016	ASIC Corporations (Disclosure in Dollars) Instrument 2016/767 (Followed the sunsetting of Class Order [CO 04/1430] *Dollar disclosure: Unknown facts or circumstances*; Class Order [CO 04/1431] *Dollar disclosure: Cost of derivatives, foreign exchange contracts, general insurance products and life risk insurance products*; Class Order [CO 04/1432] *Dollar disclosure: Interest payable on deposit products*; Class Order [CO 04/1433] *Dollar disclosure: Non-monetary benefits and interests*; and Class Order [CO 04/1435] *Dollar disclosure: Amounts denominated in a foreign currency*. Note, [CO 04/1430] and [CO 04/1432] were repealed.)
September 2017	ASIC Corporations (Financial Counselling Agencies) Instrument 2017/792 (Followed the sunsetting of ASIC Class Order [CO 03/1063] *Licensing relief for financial counselling agencies*)
January 2018	ASIC Corporations (Life Insurance Commissions) Instrument 2017/510