

Consultation Paper 214: Updated record-keeping obligations for AFS licensees

Submission

1 November 2013

The Stockbrokers Association of Australia would like to make the following comments on the proposals contained in ASIC Consultation Paper 214 *Updated record-keeping obligations for AFS licensees (CP214)*.

In CP214, ASIC proposes to update the record-keeping requirements for licensees giving personal advice to retail clients, particularly in relation to records of compliance with the best interests duty, on-going fee arrangements, and conflicted remuneration.

While our Members **agree** that the relevant licence condition on 'appropriate advice' needs to be updated for the FOFA best interests duty, we wish to make the following comments:

- existing record-keeping, training and supervisory requirements are sufficient, and should not be replicated in the advice requirements;
- the rationale for the bulk of the changes is not clear;
- the changes will lead to administrative and costs burdens; and
- the apparent urgency of the changes is not justified.

More detailed comments are also made on particular proposals. Stockbrokers' superior management and supervision standards and excellent complaints record at FOS are noted. These matters, together with the new Government's likely action on FOFA, should be taken into account in determining whether the proposals in CP214 should proceed.

1. Current Requirements

Currently, the relevant standard AFS Licence condition (**PF209 Clause 57(b)**) requires licensees to retain the following documents for 7 years:

- (b) a record of the following matters relating to the provision of personal advice to a retail client (other than personal advice for which a Statement of Advice (“SOA”) is not required or for which a record of the advice is kept in accordance with subsection 946B(3A):
 - (i) the client’s relevant personal circumstances within the meaning of subparagraph 945A(1)(a)(i); and
 - (ii) the inquiries made in relation to those personal circumstances within the meaning of subparagraph 945A(1)(a)(ii); and
 - (iii) the consideration and investigation conducted in relation to the subject matter of the advice within the meaning of paragraph 945A(1)(b); and
 - (iv) the advice, including reasons why advice was considered to be “appropriate” within the meaning of paragraphs 945A(1)(a) to (c)

2. Proposals in CP214

In CP214, ASIC proposes to change PF209 Clause 57(b) to reflect the best interests duty, and to add provisions relating to the other new FOFA requirements to avoid conflicts of interests and provide fee disclosure statements, so that records must be kept for 7 years of the following:

- (a) the information relied on and the action taken by the advice provider that show the advice provider has acted in the **best interests** of the client for the purposes of s961B(1);
- (b) if s961B(2) is being relied on to show that s961B(1) has been complied with, the information relied on and the action taken by the advice provider that satisfy the safe harbour steps in s961B(2);
- (c) the advice, including reasons why advice is considered to be ‘appropriate’ within the meaning of s961G;
- (d) where an advice provider knows, or reasonably ought to know, that there is a **conflict between the interests** of the client and the advice provider, or one of their specified related parties, the information relied on and the action taken by the advice provider that show the advice provider has given priority to the client’s interests when giving the advice for the purposes of s961J;
- (e) any **ongoing fee arrangement** entered into with the client within the meaning of s962A;
- (f) any assignment of an ongoing fee arrangement;
- (g) a fee disclosure statement given to the client under Div 3 of Pt 7.7A;
- (h) a renewal notice given to the client under Div 3 of Pt 7.7A;
- (i) any notification from a client given under Div 3 of Pt 7.7A that they elect to renew their ongoing fee arrangement; and
- (j) any fees charged after the termination of an ongoing fee arrangement.

As is the case with the current provisions, the requirements in (a)–(c) above would not apply to personal advice for which an SOA is not required (i.e. *further advice*¹). Further, ASIC is proposing a new licence condition be imposed in relation to **conflicted remuneration** so that records of the following would need to be kept for 7 years:

- (a) any arrangement, or any change to an arrangement, on the basis of which the licensee considers that the **conflicted remuneration provisions** in Divs 4 and 5 of Pt 7.7A **do not apply** to the licensee or its

¹ *Corporations Regulation 7.7.10AE* effective 20 December 2005 replaced *further market-related advice* with *further advice* in section 946B

- representatives because of the **transitional provisions** in s1528–1531 of the Corporations Act and the regulations made under those sections;
- (b) any payments made or accepted under arrangements to which the **conflicted remuneration provisions** in Divs 4 and 5 of Pt 7.7A **do not apply** to the licensee or its representatives because of s1528–1531 of the Corporations Act and the regulations made under those sections; and
 - (c) where the licensee relies on the exemptions in s963B or 963C of the Corporations Act, or Div 4 of Pt 7.7A of the Corporations Regulations, to **form the view** that a monetary or non-monetary **benefit** that is given to the licensee or its representatives **is not conflicted remuneration** (e.g. the *stockbrokers carve-outs* and *stamping fees* exemption), records demonstrating the circumstances on which this reliance is based.

3. Comments

- a. **Rationale doubtful:** in CP214.17, ASIC states that the proposed additional record-keeping requirements are '**implied**' by two existing licence conditions in s912A, namely the obligation to act *efficiently, honestly and fairly*, and the obligation to have *adequate dispute resolution systems*. We respectfully disagree. While members would expect that the licence condition PF57(b) which refers to the previous section 945A would be updated for the new best interests duty, the proposals go much further than this, without justification. The new FOFA requirements are legal requirements of the licensee, and it is up to the licensee to comply. If the licensee does not, it is liable to legal action from clients and regulatory action from ASIC. This is a legal fact. It is not necessary for records of every step of every obligation to be recorded and verified. The proposals are more of a matter of convenience for ASIC in surveillance activities than a justifiable impost on the industry. They go much further than is required, especially for stockbrokers. Moreover, good record-keeping is already embedded in our Members' operations, since the value of good records, especially in the context of advice, is well known.
- b. **Urgency not justified:** any concern of ASIC that there is somehow a 'gap' in the Pro Forma licence conditions should be allayed by the fact that licensees, especially stockbrokers, continue to be caught by the general compliance and supervision requirements. While PF209 Clause 57(b) should be updated to take into account the new best interest duty in due course. Undue urgency, as well as the additional areas sought to be added to the record-keeping requirements, are not justified, especially when further amendments to the best interests duty may be made by the new Federal Government.
- c. **Administrative and Cost Burden:** In CP214, ASIC seems at pains to stress that by imposing the new requirements, it does not intend to impose an '**administrative burden**' on licensees². However, our Members are concerned that the proposals will do just that, imposing new administrative burdens on their businesses, in terms of systems, policies and procedures. Additional documents lead to changes in systems, policies and procedures, and additional cost, with no appreciable benefit to clients. It is not clear

² See ASIC Media Release 13-196MR, and the following paragraphs in CP214: CP214.20; CP214.50; and CP214.57

from the Consultation Paper whether, for example, the specific information on which the representative relied in formulating the advice would need to be included in client files. Typically, stockbrokers retain electronic records of research materials on internal computer systems which can be retrieved when required. Given the small number of complaints experienced by stockbrokers (see f. below), there appears to be no justification for requiring such information to be recorded on a client-by-client basis.

- d. Specific proposals:** specific advice record-keeping should be separated from management and supervision requirements. In many cases, the records are already being kept, so further prescriptive requirements are superfluous, redundant and unnecessary. In relation to particular proposals -
- i. **Training:** records of training proposed in RG175.403 (Attachment 1 to CP214) already exist under training requirements, specifically licence conditions PF209 Conditions 6&7;
 - ii. **Proposal B1(b) Action taken** under s961B(2): keeping a record of 'action taken' is excessive as it is self-evident from the client records or history. In addition, providing advice is a *process* which involves the exercise of the judgment by the provider of the advice. For example, in addition to the compliance with training and accreditation requirements referred to above, the representative must, before providing advice to a client, make a decision whether they have the expertise to provide advice to the client (section 961B(2)(e)(i) and (ii)), based on their knowledge of their own expertise and what the client is seeking. It would be an administrative burden imposed on the industry to establish further procedures to document such judgments. Experience also suggests that, in the event of a complaint or disciplinary action, the adequacy of the expertise and judgment by the representative is likely to be readily observable;
 - iii. **Proposal B1(b) Expertise** under s961B(2): keeping a record of expertise is unnecessary as it is part of the firm's training records. It is also up to the firm to supervise and make sure that the adviser has the necessary expertise in the products and services being offered. Moreover, it is a standard licence condition for retail advisory firms that representatives be adequately trained and competent to provide the relevant product or service;
 - iv. **Proposals B1(d) Conflicts:** this is excessive. If the firm acts in an IPO or other corporate action it is well known, disclosed to clients and there are sufficient records already. A firm should not have to create any new records under these new licence conditions. As outlined in ASIC RG 181.20, the licensee may generally manage conflicts by avoiding, controlling or disclosing the conflict. The record-keeping obligations outlined in RG 181.45 are adequate, so Proposal B1(d) is superfluous regulation that would add additional cost burden to the industry by requiring development of additional processes and ongoing administration;
 - v. **Proposals B1(e) - (j) fee arrangements:** again these are superfluous as they are already caught by existing requirements;

- vi. **Scaled Advice:** one of the stated aims of FOFA was to facilitate scaled advice, for instance advice on particular products, rather than holistic financial planning. The additional record-keeping requirements of CP214 do not facilitate scaled advice. Worse still, they may encourage ‘further advice’ to avoid a new SOA, even where a change in circumstances requires one. Scaled advice obligations are detailed in AIC Regulatory Guide 244 *Giving information, general advice and scaled advice*, as well as ASIC Regulatory Guide 175 (ASIC RG 175.387 – 175.391). It should not be necessary to increase record keeping in relation to scaled advice.
 - vii. **Proposals B2 Conflicted Remuneration:** once again, these record-keeping requirements cross-over into ground already covered and are unnecessary. The decision as to whether a particular benefit is conflicted remuneration, or whether one of the exceptions to conflicted remuneration applies, is **not** one for the adviser giving personal advice. It is a decision for the licensee, which is responsible for the advice given and the supervision of all its representatives. For example, it would be dangerous for a firm to leave it to an adviser to determine whether a particular benefit comes within the *stockbrokers carve-outs*, or the *stamping fee exemption*. **The Firm** will decide whether any exemptions apply, and if not what action is to be taken, e.g. seeking client consent to the benefit. The Firm will make (and most firms have already made) those decisions based on the new provisions, with the assistance of legal advice if required, and the Firm will retain records of those decisions, independent of any advice given.
- e. **Stockbrokers’ superior management & supervision:** The new requirements seem to cross-over into the realms of existing management and supervision requirements. The proposals do not take into account stockbrokers’ higher standards and requirements of management and supervision. Under the enhanced management and supervision requirements of the *ASIC (ASX Markets) Market Integrity Rules (MIR)*, market participants must ensure that they have supervisory policies and procedures to ensure compliance with *all* their obligations under the *Corporations Act*, the MIR and the *ASX Operating Rules*³. Under the MIR, breaches of these requirements can attract penalties including fines of up to \$1m. No other sector of the financial advice industry is subject to such sanctions. Record-keeping is already a key part of these policies and procedures. Management structures must be lodged with ASIC, and must ensure compliance with the rules and requirements. Further strength is added by the requirement that these structures be designed, supervised and reviewed by Responsible Executives (**REs**). REs have higher standards than normal Responsible Managers of AFSLs, including the requirement to pass compulsory examinations and undertake prescribed CPD⁴. REs must provide annual sign-offs to their firm that their area of responsibility has been undertaken in compliance with the applicable rules and that **documentation** exists to prove it. The market participant must then certify to ASIC that its REs have fulfilled their

³ Market Integrity Rule 2.1.3; ASX Clear Operating Rule 3.5.1 (for Clearing Participants)

⁴ Market Integrity Rule 2.1 & 2.3; ASX Clear Operating Rule 4.8 (for Clearing Participants)

requirements.⁵ Therefore, ASIC should be comfortable that there are already provisions in place to ensure proper supervision of stockbrokers' businesses, including record-keeping.

- f. **FOS Figures highlight high standards:** if complaints handling is one of the key reasons for these new requirements, figures released by the **Financial Ombudsman Service** would suggest that stockbrokers already handle complaints very well indeed. For the last three financial years, complaints against stockbrokers have accounted for 5% or less of the total complaints involving investments to FOS, the bulk of which are made against financial planners and advisers. As the following table shows, in FY2013 only 63 out of 32,307 complaints – including 1214 relating to investments – were made against stockbrokers:

Financial Year	2013	2012	2011
Total Disputes received (all categories)	32,307 (↓11%)	36,099 (↑19%)	30,283 (↑27%)
Total Investments Disputes accepted	1214 (↓25%)	1626 (↓14%)	1886 (↑15%)
Total Stockbroker Disputes accepted	63 (-)	63 (↓5%)	66 (↓36%)
Stockbroker Disputes as % of Investments Disputes	5%	4%	3%

Source: FOS Annual Reviews Financial Years 2013, 2012 & 2011

While complaints against financial planners tend to be dominated by complaints about inappropriate *advice*, there are relatively few complaints against stockbrokers about advice, with those complaints accounting for just 12 out of the 63 complaints in FY2013 and 7 out of 63 in FY2012.

While it would be reasonable to expect that ASIC would update the existing 'appropriate advice' condition for the FOFA best interests duty, the ASIC proposals go too far and are not necessary, as they either already exist elsewhere through normal management and supervision controls and AFS Licence Conditions, or are burdensome and not justified.

Moreover, the proposals by ASIC ought to await the new Government's measures to address issues in relation to FOFA. The new Government's plans were outlined (whilst in Opposition) in the [Dissenting Report](#) of the Parliamentary Joint Committee Inquiry into the FOFA Bills in February 2012. Of the 16 recommendations in the Dissenting Report, the following may have a significant effect on the proposals in CP214:

- a) Removal of **biennial opt-in** for continuing fee arrangements (Recommendation No.3)
- b) Streamlining **fee disclosure statements** (Recommendation Nos.4&5)

⁵ Market Integrity Rule 2.3; ASX Clear Operating Rule 4.22 (for Clearing Participants)

- c) **Best interests duty** - removal of catch-all duty in s.961B(2)(g) (Recommendation No.6)
- d) **Scalable advice** - explicit provisions (Recommendation No.7), and
- e) **Conflicted Remuneration** provisions to only apply to Personal Advice, not General Advice (Recommendation No.10)

Thank-you for the opportunity to comment on the proposed changes to the record-keeping requirements for retail advice. We would be happy to discuss these matters further at your convenience. Should you require any further information, please contact me, or Doug Clark, Policy Executive on

Yours sincerely,

David W Horsfield
Managing Director/CEO
Stockbrokers Association of Australia