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24 November 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: corporations.joint@aph.gov.au

Dear Committee Secretary

**Submission to the Parliamentary Joint Committee on Corporations and Financial Services**

Burrell Stockbroking and Superannuation is pleased to provide a submission to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the proposed *Corporations Amendment (Future of Financial Advice) Bill 2011* (**Bill**).

We are concerned that the in the current form the Bill will not achieve its intended purpose of ensuring independent financial advice that is value for money. The new opt-in and disclosure provisions discriminate against business models that charge ongoing retainers to clients, when in fact charging a retainer is the leading business model and ensures the best value for clients. We are also concerned that the Bill does not recognise existing disclosure requirements and this will lead to duplicate disclosure requirements. Further, we believe that the Bill should reflect current disclosure requirements by allowing a standard fixed date for disclosure.

Burrell Stockbroking and Superannuation's submission also addresses issues concerning the lack of scalability with respect to the Best Interests Obligation, the ban on charging asset-based fees on borrowed funds and the ban on receiving third party fees. Like many others in the industry we also question the true cost that the new Future of Financial Advice reforms will have on the industry.

If you have any questions or comments regarding Burrell Stockbroking and Superannuation's submission please contact me. We request the opportunity to address the committee in Sydney on the 23rd of January, 2012.

Yours truly

Chris Burrell

Managing Director Burrell Stockbroking and Superannuation

MFM, BCom (Hons), LLB (Hons), FCA, SF Fin, MSDIA

**Burrell Stockbroking and Superannuation**

*Corporations Amendment (Future of Financial Advice) Bill 2011*

**Submission**

24 November 2011

# Introduction

Burrell Stockbroking and Superannuation is a medium sized private firm offering full service stockbroking, superannuation and wealth management advice to both wholesale and retail 'mum and dad' clients. Burrell Stockbroking and Superannuation is a participant of the Australian Securities Exchange (**ASX**) and the National Stock Exchange of Australia (**NSX**).

We are pleased to provide this submission to the Parliamentary Committee on Corporations and Financial Services, on the *Corporations Amendment (Future of Financial Advice) Bill* (**Bill**).

In this Submission the focus will be on:

1. The Opt-in obligation (for Ongoing Fees);
2. Staggered disclosure dates and the detail required by new disclosure provisions;
3. Scalability with respect to the Best Interests Obligation;
4. Ban on charging asset-based fees on borrowed funds; and
5. Ban on receiving third party fees.

# 1. The Opt-in obligation (for Ongoing Fees)

The purposes of the new opt-in provisions in s962N are explained in the Explanatory Memorandum to the Bill as protecting 'disengaged clients from paying ongoing financial advice fees where they are receiving little or no service.' [1] Further, the Explanatory Memorandum explains that 'for those clients that are not disengaged, the renewal requirement will provide them with an opportunity to consider whether the service they are receiving equates to value for money.'[2] The focus of the Bill should be on whether fees are reasonable, not the ongoing nature of the fees. In most instances ongoing fees in relation to advisory services provide clients with value for money. By discriminating against ongoing fees Burrell Stockbroking believes the opt-in provisions will not have the desired effect of ensuring clients obtain the best outcome. Opt-in will disengage clients and discourage business models that are value for money. It is Burrell Stockbroking and Superannuation's opinion that opt-in should be removed from the Bill, or at the least the legislature should adopt an opt-out policy.

### 1.1. Charging ongoing fees is the leading business model

The stockbroking sector of the financial services industry generally operates on one of two business models. The first model is high turnover commission only. The alternative model is based on low turnover coupled with an advice fee based on the percentage of total holdings. Burrell Stockbroking and Superannuation operates predominantly by the second model as it provides clients with valued advice at a low rate. Our Firm offers clients the choice of whether to pay an upfront fee for advice, or alternatively pay an ongoing retainer. Almost every client has chosen a retainer. The Bill threatens to undermine this business model. It is our belief that charging by way of recurring income is one of the leading business models for the financial services industry when it comes to giving advice. Clients are skeptical of having to pay a time based fee for financial services. Time based fees lead to distrust as clients believe the fees are open-ended. Simply put, clients do not want nor do they trust time based fees. Conversely, charging a retainer where the client is not locked in encourages valued advice and does not lead to lower service levels once the upfront costs are paid. As a client incurs no significant upfront cost under a retainer, if they are not satisfied with initial advice provided they can terminate the relationship at far less cost than fee-for-service. As such, the opt-in policy should be removed as it discriminates against one of the leading business models of the industry.

### 1.2. At a minimum Opt-in should be limited to 'financial product advice' or to third party contracts

We agree with concerns raised by many others in the industry that clients will inadvertently fail to opt-in, which would leave them exposed to adverse market conditions. Burrell Stockbroking and Superannuation and the industry in general already allow clients the ability to opt-out at any stage or by complying with a short notice period (our Firm currently requires one month's written notice). We, like many in the industry, believe that opt-in should be removed from the Bill. Alternatively, at the least, opt-out should be adopted. Opt-out provides clients with safeguards while allowing the financial industry to focus on clients and not complying with over burdensome regulatory conditions. However, if opt-in is to continue we believe that the scope of the concept should be limited.

[1] *Corporations Amendment (Future of Financial Advice) Bill 2011* cl 1.5.
[2] Ibid.

The definition of 'ongoing fee arrangement' in s962A is too broad. The current definition includes all 'financial services'. It is our opinion that the definition should be restricted to 'financial product advice'. This definition would still facilitate the ban on conflicted remuneration while allowing client focused advisory services and products that assist the client in understanding their portfolio and investments, such as electronic portfolio services, to continue. An alternative method, that will achieve the same aims of controlling conflicted remuneration while allowing the client preferred business model to continue, is limiting opt-in to third party contracts.

### 1.3. Cost of opt-in

In *Media Release 127* dated 29 August 2011 the Hon Bill Shorten MP stated that 'Rice Warner have estimated the cost of opt-in to be around $11 per client. This includes set-up costs and the cost of chasing up clients who are charged on-going fees but who advisers may not be in regular contact with.' It is our opinion that this cost has been grossly underestimated. If the legislature believe that all opt-in will require is sending a notice to clients they are mistaken. Opt-in will require meeting with the client to renegotiate contracts and costs. We calculate the time of such a meeting, including preparation, to be more than two hours. As such, the cost of opt-in per client will be around $650 per client. Further, even in the unlikely event that a meeting is not conducted the cost of compliance with opt-in alone would be between $50 and $100. The cost of opt-in is likely to push many independent financial advisers out of the industry. This will lead to less independent advice which is counterintuitive to the Bill's aims.

### 1.4. Where a client is silent on opt-in

The legislation is not clear on the duties owed by advisers where a client is silent on opt-in. Clients are notorious for not returning paperwork. It is our and the industry's opinion that many clients would inadvertently fail to opt-in, and many would become disengaged and lose trust in their adviser through the opt-in process. As such, if opt-in is implemented the legislation should be more robust on the fact that no liability attaches, and there are no continuing duties, such as to warn about adverse market conditions, once the date for renewal passes. Further, the fact that opt-in will lead to clients being exposed to adverse market conditions emphasises the need for its removal.

## 2. Staggered disclosure dates and the detail required by new disclosure provisions

### 2.1. Staggered disclosure dates

It is our opinion that s962J is unclear as to whether providers can set a particular date each year for disclosure to occur. The Stockbroking and Wealth Management industries do not operated like fund providers or the insurance industry. Many participants in our industry do not have automated processes that can track when a client entered into an agreement. Tracking the date a client entered into an agreement has little benefit for our industry. Further, we can not comprehend any reason why having the ability to set a standardised date would not achieve the same outcomes.

### 2.2. Avoid duplication with current disclosure requirements

As a market participant Burrell Stockbroking and Superannuation already complies with a high standard of fee disclosure. Our Firm conducts, at minimum, yearly reviews with wealth management and most other classes of clients. Fees are disclosed to all new clients via the Firm's Financial Services Guide. Further, for managed discretionary accounts we are required to comply with disclosure requirements in the *Corporations Act* and under the ASIC market integrity rules. The standard date for compliance is 30 June each year. The Bill should reflect this standard date and ensure that there is no duplication of disclosure between the various legislative instruments.

### 2.3. Level of detail required by disclosure

The issue is once again that Burrell Stockbroking and Superannuation and the industry in general do not have the systems in place to comply with the disclosure requirements. We agree with the general sentiment across the industry that the 'data does not exist' in order to be able to comply with the standard of disclosure expected.[3] The cost of installing and implementing the systems to provide the required disclosure information will be a significant burden on our business and increase the cost of advice and services provided. Further, a major issue is that the information required to calculate these costs would be contained across various platforms which will not always be under our control. It is our opinion that the Committee needs to reconsider their costing analysis, and this needs to be reflected in the legislation.

[3] Mike Taylor, 'FOFA: Living life by ava-tranche' 25(43) *Money Management* 12.

# 3. Scalability with respect to the Best Interests Obligation

### 3.1. Definition of 'subject matter' limiting scalability

The proposed section 961C(2) in the Exposure Draft to the Bill requires an adviser to investigate and disclose in writing to clients where it is 'reasonably apparent' that another 'subject matter' could better achieve the client's objectives. The definition of subject matter is not limited to the class of financial product or products that the adviser has expertise in. It is our opinion that the definition of subject matter is too broad and uncertain and does not facilitate scaled advice.

Of major concern is that the Explanatory Memorandum to the Bill fully contemplates the concept of limited or scaled advice, whereas the draft legislation does not. Under the detailed explanation of the new law referring to 'acting in the best interests of the client' under paragraph 1.29 it states that the Best Interest requirements have been designed to accommodate the provision of (1) limited (scaled) advice that only looks at a specific issue and (2) holistic advice that looks at all the financial circumstances of the client. Further, it explains that in situations where limited advice has been requested the adviser is able to tailor the information obtained about the client solely to what is necessary to provide that form of advice. Due to the broad and uncertain definition of subject matter in the Exposure Draft to the Bill it is our opinion that advisers will not be able to tailor information to what is necessary to provide advice. The legislation should reflect ASIC's view of facilitating scaled advice.[4]

We can see no specific reference to the concept of limited advice in the draft legislation. For the intention to be clear there needs to be specific provisioning in the legislation for limited advice. In its current form the obligation the Bill places on the adviser would go wider than the concept of scaled advice. Providers would be required to use professional judgment and advise clients if they believe advice on another subject matter could better meet the client's needs and objectives, or further still, the adviser is required to assess whether the client's needs would be better satisfied by not acquiring financial products. Where an adviser is an expert in say one area of financial product, and is qualified as such, they would not be in a position to make other recommendations outside of that area. This applies to a stockbroker who receives a request to provide advice in relation to the shares in say a (prospective) client's share portfolio. The enquiries of the client by the adviser are limited to, for example, the portfolio and whether the client is seeking growth or income, the investment horizon, and the level of risk that the client is willing to accept. Therefore, the advice sought is limited and there should be no obligation on the adviser to go outside of this. This needs to be made clear in the legislation.

Burrell Stockbroking and Superannuation believes that most of the issues concerning the definition of 'subject matter' have been rectified in the *Corporations Ammendment (Further Future of Financial Advice Measures) Bill* (**Second Bill**). However, we are still concerned that the Second Bill does not use the term 'scalable advice'. We appreciate that the Second Bill goes someway to utilizing the concept of scalable advice. However, to clarify the issue, it is out view that the legislature should specifically reference and define the concept of scalable advice in the Second Bill.

[4] ASIC Consultation Paper 164 *Additional guidance on how to scale advice* July 2011 ('CP164').

### 3.2. Removal of 'relevant personal circumstances' effect on scalability

The Second Bill plans to repeal Subdivision B of Division 3 of Part 7.7 of the *Corporations Act* (**Act**). One effect of this is that the concept of 'relevant personal circumstances' will be removed from the Act and replaced with the s961C. We are concerned that the removal of the relevant personal circumstances concept will mean that scalability is further diminished. If advisers cannot scale their advice to a client's relevant personal circumstances, then the relevance and cost of the advice to the individual client will increase. The Second Bill introduces the concept of 'client's relevant circumstances'. It is our opinion that this concept will not foster relevant and cost effective advice unless it is combined with scalability. We again recommend that the legislation specifically acknowledge scalability and retain the concept of relevant personal circumstances.

Attached in is an extract from the Client Guide for our Firm. Based on our own and ASIC's view of scalability, the following scalability is discussed with clients:

- Execution only advice
- General advice
- Portfolio advice
- Wealth management advice (superannuation, estate planning and portfolio advice).

# Choice of Service

You are able to choose what level of service you want us to provide, from: trade execution only services, with either no advice or general advice only; trading account, with personal advice; investment portfolio services, with personal advice; and, wealth management services, with personal advice.

## *Types of advice*

'General advice' is giving you information that does not take into account your financial circumstances, situation, or needs, and it will be up to you to decide if the information we give is suitable for you. An example of general advice is: you say to your advisor you are interested in ABC Co Ltd and we send you our research note, which carries a BUY recommendation. In the absence of your advisor specifically recommending you buy shares in ABC Co Ltd, that recommendation is our general opinion of the company only, and you will have to decide whether to buy shares in it.

When providing 'personal advice', our advice will be tailored to suit to your relevant financial circumstances. However, in order for us to do this, we require enough information about you to develop the personalised advice. Therefore, we ask that you complete in full whichever of the forms that relate to the service level you choose. Your advisor can assist you with this. If you do not provide us with the information we require to tailor our advice to your financial circumstances, then our advice will be limited to the information you do provide, and you will need to decide if the financial product or service is suitable for you.

If, at a later date, your circumstances, (financial objectives, risk profile, or investment horizon), change materially, you must let us know so that we can continue to provide advice best suited to your requirements.

# 4. Ban on charging asset-based fees on borrowed funds

### 4.1. Achieving the objective of stopping over-gearing

In order to mange risk, clients who use borrowed funds for investment purposes need a higher level of advice than clients who invest their own funds. We advise clients who borrow funds for investment to operate a low risk strategy, such as investing only in blue chip stocks. Removing the ability to charge asset-based fees on borrowed funds will diminish the level of advice provided to clients who borrow. It is essential that clients who borrow continue to access professional advice to manage their risk. The Bill should reconsider the ban on charging asset-based fees on borrowed funds.

Placing a ban on asset-based fees on borrowed funds is not the way to stop over gearing, the like of which lead to the Storm Financial collapse. If an adviser has correctly and diligently obtained a client's information and objectives, then appropriate advice would mean a client is not over geared. For example, our Firm cautions margin loan clients to keep the LVR under 40%. We specifically advise *against* double gearing. Further, being able to charge on the total value of the portfolio reflects the value of the advice given. Accordingly, the ban on asset based fees on borrowed funds should be removed. It is our opinion that the 'best interest duty' would be sufficient to ensure gearing is controlled.

## 5. Ban on receiving third party fees

We support the view that providers can continue to be paid a fee for service by financial service product providers under the proposed S 964(2)(a). This will allow providers to continue to ensure clients are presented with quality financial products without having to pass on additional costs. We are concerned that section 964(2)(a) has been removed from Bill Two. We believe that this removal will mean that providers are not permitted to receive service fees from third party product providers. This will greatly increase costs and lead to less providers offering financial products. Accordingly, s 964(2)(a) should be retained.