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Secretariat, Quality of Advice Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: advicereview@treasury.gov.au

Dear Treasury

Quality of Advice Review Proposals Paper

1. Thank you for releasing a high-level Proposals Paper at this interim stage of the Review. It has provided an important opportunity to test the Review's current thinking on the best way forward. My comments are similarly high-level and will hopefully help develop and refine the Review's thinking, even where we do not agree. I focus here on issues of design (rather than detail) to keep this note as brief as possible.

Accessible and affordable – and adequate

2. The Proposals Paper frames the purpose of the Review as being 'to consider whether changes should be made to the regulatory framework applying to financial advice to improve the accessibility and affordability of financial advice'. I would add a third "A" – adequacy. It is important that the Review also does the work asked of it by Recommendation 2.3 of the Hayne Royal Commission into misconduct in the banking, superannuation and financial services industry (2019).

3. Financial advice that is offered in trade or commerce should be of adequate quality, and regulation should begin with that as its focus. (Professional standards and robust competition can and should continue to lift the quality of advice beyond the merely adequate, but legal regulation should draw the baseline.)

4. I think there is a public interest in making individualised financial advice (of adequate quality) accessible and affordable for ordinary households experiencing key life-events that involve complex financial decisions. Household formation, transition to retirement, and financial distress are the obvious examples. But I am not sure there is a compelling public interest in improving the accessibility or affordability of privately-provided, individualised advice more generally. I am more interested in focusing attention and resources on developing scalable assistance and education on mainstream financial decisions at a cohort or community level (for example, through a replacement to MoneySmart). Of course, others have a different view.

5. If accessibility and affordability in individualised advice are important, they will only realistically be achieved at scale through innovation. Red-tape reduction for existing advice providers may marginally reduce input costs but it is not clear how – or if – any savings would be passed onto households or how the supply of adequate advice would increase. New business models are needed. The best thing that regulatory reform can do is get out of the way of innovation while reaffirming the core legal principles that ensure that advice is of adequate quality – regardless of how or by whom it is provided.

6. Australia has had several attempts at regulating financial advice this century and some people might be cynical about what can be achieved through the Review. I am not. All reform is incremental and of its time. The Review is an important opportunity to take the next step.

What should be regulated?

7. I agree we should distinguish between 'financial advice' that can be regulated appropriately under the general consumer laws and that which needs additional specialist regulation. (I am deliberately avoiding the language of 'general advice' and 'personal advice' here, because of the historical baggage, but that is the broad idea.)

8. I use 'financial advice' in its ordinary sense, not as a term of art. In very broad terms I mean advice (which is not an opinion, rather it is 'an opinion recommended, or offered, as worthy to be followed') relating to financial decisions (which are not the same as decisions that have financial implications). It is not the same as 'financial product advice' as currently defined.

9. As always in regulation, the perimeter is key. My perimeter is differently drawn from the one in the Proposals Paper. Based on the behavioural science literature, I think financial advice needs specialist regulation if it has the following five important attributes:

    a. it is provided in trade or commerce

    b. it is provided to a recipient whose identity is known to the provider

    c. it concerns a financial decision that is material to the recipient,

    d. it is reasonably understood by the recipient to be formulated having regard to information known to the provider about the recipient's personal circumstances and objectives, and

    e. it is reasonably understood by the recipient to be formulated using the provider's judgment.

    I will call this kind of advice 'category 2' for now. (There are some drafting issues in providing sufficient certainty for providers to know ex ante if advice is category 2, but they can be addressed – it is the concept that matters for now.)

10. Financial advice that has the attributes in paragraph 9 is probably fiduciary in character, regardless of whether there is a pre-existing or ongoing relationship between the provider and the recipient, or the subject matter or scope of the advice.

11. Category 2 advice might be formulated and delivered by a human or digitally.

How should category 2 advice be regulated?

12. An entity that carries on a business of providing category 2 advice should hold an Australian financial services (AFS) licence, with all that entails. I think AFS licensing should be at the entity level (not the individual level) but I note the issues around 'relevant providers' (see paragraph 23 below).

13. If category 2 advice is provided to a recipient who is a 'financial consumer', additional statutory protections should apply. A financial consumer is not the same as a 'retail client' – I think the additional protections afforded by specialist regulation should apply if the recipient is a household (in the sense I used that concept in the Hayne Royal Commission Background Paper 7) or a small business – noting there are some definitional nuances here to align the framework with Australian Financial Complaints Authority (AFCA) and to deal with self-managed superannuation funds.

14. I said in paragraph 13 that additional statutory protections – beyond the general AFS licensing laws – should apply when a provider gives category 2 advice to a financial consumer to achieve advice that is of adequate quality.

15. I do not agree with the proposal to impose a statutory obligation to provide 'good advice' (I say why briefly in paragraph 18). Instead, I think the provider (see paragraph 20) should be subject to express statutory duties that are based on well-understood legal concepts, consistent with existing laws governing commercial fiduciaries that make decisions about other people's money (including responsible entities, superannuation trustees, and their officers), and make sense across all forms of category 2 advice. Broadly, the duties are:

    a. a duty to act honestly

    b. a statutory duty of care, reflecting existing legislative drafting for commercial fiduciaries and including a negligence safe-harbour for competent, disinterested advice

    c. an undiluted statutory best interests duty, reflecting existing legislative drafting for commercial fiduciaries

    d. a statutory requirement for disclosure of conflicts, including those arising from vertical integration, reflecting existing legislative drafting for commercial fiduciaries

    e. a prohibition on conflicted remuneration (probably retained from Pt 7.7A Div 5 – 7 with red-tape refinements)

    f. a requirement to disclose all episodic or ongoing fees payable to the provider and have them agreed by the recipient at least annually

    g. a requirement to retain adequate records of information and instructions from the recipient and the advice given to the recipient and provide them to the recipient on request.

16. For this approach to work, any legislation should reflect the legislative design and drafting principles proposed by the Australian Law Reform Commission (ALRC) and, consistent with the recommendations of the Hayne Royal Commission, should not contain carve-outs or qualifications that are based on the identity of the provider or the subject-matter of the advice (for example, insurance or investments and probably credit). They should be succinctly expressed (think, for example, directors' duties in Pt 2D.1 of the Corporations Act). The appendix shows what this approach could look like. In it I have deliberately used concepts that have settled legal meaning and can be applied having regard to existing caselaw. I have not included the consequence provisions (civil, civil penalty, and criminal liability) but this would follow the usual pattern.

17. The benefits of putting these provisions in the statute are that: they cannot be contracted out of or watered down; they enliven the statutory penalties and remedies; they set the context for interpreting other interlinked statutory provisions (such as s 912A of the Corporations Act); they provide a clear foundation for the exercise by AFCA of its decision-making functions; and they cannot be dodged or finessed by providers who say they do not know what they mean or that they can only be met by providing wholistic financial planning (neither of which is true).

18. I prefer this approach to the statutory obligation to provide 'good advice' which is put forward in the Proposals Paper. This is because the provision of category 2 advice requires the exercise of commercial (and in some situations professional) judgment by the provider. There is more than one possible right answer, and every advice scenario is different. In other situations where fiduciaries are required to exercise their commercial judgment, the law typically resists a model that invites or requires an ex post review of the merits of the decision. (Deciding whether advice is reasonably likely to benefit the client, having regard to the information that is available to the provider at the time the advice is provided, does seem to require assessing the merits of advice.)

19. Just to clarify, I am not suggesting retaining a 'process' obligation like the one that appears in the current Pt 7.7A Div 2 of the Corporations Act. Far from it. But I prefer a duties-based framework to an outcomes-based framework.

20. The duties would apply to the provider, which will be either an AFS licensee or a representative of an AFS licensee. (If the latter, the AFS licensee should be liable alongside the representative for the representative's conduct.) There is some nuance about who is the 'provider' to whom the duties apply – for example, for digital advice provided by a company where the financial consumer is assisted through the process by a clerk, the provider is the company not the clerk. The provider is the legal person that exercises judgment in formulating the advice – put the other way, if a person cannot determine or change the substance of the advice, they are not the provider.

21. There is debate over whether an orthodox duty of care, like the one proposed in paragraph 15b, can work where judgments involved in formulating the advice are made or assisted by AI. (The other proposed duties, such as the duty when confronted with alternatives to select the one that most benefits the recipient, are less problematic because they can be programmed in as decision parameters.) As others have observed, where an AI system is fully autonomous or is far removed from human decision-making, becomes more difficult to establish proximity and foreseeability. This is a complex question: see the current European Commission project *Civil*

liability – adapting liability rules to the digital age and artificial intelligence. I am not sure we will solve that broader problem here; it will involve careful consideration of the implied warranty in ASIC Act s 12ED (which applies to advice), the insurance framework, and the approach Australia decides to take on AI liability generally, for example in healthcare. For now, it is worth noting that, at the individual provider-recipient level, the recipient's rights to compensation under the AFCA regime does not depend on establishing negligence on the part of the provider. Similarly, ASIC's licensing powers (including under Pt 7.6) do not turn on this question.

Relevant providers

22. The difficulties with the current Pt 7.6 Div 8A – 8C reflect the relative immaturity of the advice framework, which is closer to professionalism in some areas than others. It is a work in progress.

23. Education and ethical standards should apply to individuals who are themselves 'providers' (see paragraph 20) of category 2 advice or advertise themselves as such, or who want to use a recognised individual professional title (such as financial planner, stockbroker, insurance broker, private banker, or retirement adviser as explained in paragraph 25). The education and professional standards should be tailored to the particular service category, recognising the differences between them. Professional titles should probably be linked to membership of a recognised industry body, noting there is significant work still to be done in rationalising those bodies. Industry bodies aspiring to professional status for their members should carefully consider the Professional Standards Councils framework.

24. If the provider is a body corporate rather than an individual, then it might be worth considering an 'accountable person' model (like the proposed Financial Accountability Regime) with an AFS licensing requirement that the accountable person meet the relevant education and ethical standards.

Advice in superannuation

25. I agree that improving the accessibility and affordability of individualised advice about retirement transition is important. My model contemplates the emergence of a sector -wide concept of retirement advice that assists recipients in understanding retirement entitlements (including social security) and choosing and managing suitable financial products from those offered by prudentially regulated entities. Whether this should be provided by superannuation funds, paid for by the recipient, or cross-subsidised within superannuation funds are different issues; they are really for the trustees of those funds to decide having regard to the retirement income covenant.

Disclosure documents

26. As for mandatory disclosure documents such as FSG and SoA, I would abolish them completely. Providers of category 2 advice will probably continue to provide documents or electronic records to recipients recording important advice for customer relationship and risk management purposes, but the form in which that is provided should be left to them to agree. The duty mentioned in paragraph 15g deals with any regulatory risk.

The overall framework

27. On this model, the legislation framework would broadly look like this (at least until the ALRC completes its more comprehensive reorganisation of Ch 7 of the Corporations Act):

Pt 7.1 Div 2	Replace the concept of retail client with 'financial consumer'
Pt 7.1 Div 4	Replace the concept and definition of 'financial product advice' with the idea of category 2 advice (using appropriate terminology)
Pts 7.6 and 7.8	Retain (with red-tape refinements) the AFS licensing requirements and professionalism requirements for human providers (currently 'relevant providers') and accountable persons
Pt 7.7	Remove mandatory disclosure (but note Pt 7.7A Div 3)
Pt 7.7A Div 2	Repeal and replace with the statutory duties covering the provision of category 2 advice to financial consumers (see attachment)
Pt 7.7A Div 3	Include requirements relating to episodic and ongoing fee disclosure and requiring the recipient's agreement (opt-in) at least annually
Pt 7.7A Div 5 – 7	Retain (with red-tape refinements) rules prohibiting conflicted remuneration

28. The legislation should complement (and not replace or crowd out) a provider's ethical responsibility and commercial or professional accountability for the advice they provide. All three legs of the tripod – legal duties, ethical responsibilities, and stakeholder accountability – are required to support the provision of high-quality advice.

29. A financial consumer's access to individual remedies for defective advice through AFCA – which does not depend on the consumer proving that the provider contravened a statutory duty – is integral to this model. AFCA's decision-making takes account of legal duties, ethical responsibilities, and professional standards. Design and distribution obligations on financial product issuers are also relevant in striking the appropriate balance (although they require further work, as the Review notes).

30. I wish you well with the next stages of the Review.

Yours sincerely

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APPRENDIX - Replacement Pt 7.7A Div 2

SD1 Application

This Division applies to a person (the provider) who provides category 2 advice to a financial consumer (the recipient).

SD2 Duties of provider

(1) In providing advice to a recipient, a provider must:

(a) act honestly; and

(b) exercise the degree of care and diligence that a reasonable person would exercise if they were in the provider's position; and

(c) act in the best interests of the recipient and, if there is a conflict between the interests of the recipient and the interests of the provider, give priority to the recipient's interests; and

(d) not make improper use of information acquired through being a provider to gain an advantage for the provider or another person or cause detriment to the recipient; and

(e) not make improper use of their position as a provider to gain, directly or indirectly, an advantage for themselves or for any other person or to cause detriment to the recipient.

Competent provider rule

(2) A provider is taken to meet the requirements of paragraph (1)(b), and their equivalent duties at common law and in equity, in respect of the advice if they:

(a) formulate the advice in good faith; and

(b) do not have a material personal interest in the subject matter of the advice; and

(c) inform themselves about the subject matter of the advice to the extent they reasonably believe to be appropriate; and

(d) take into account relevant information they possess about the personal circumstances and objectives of the recipient in formulating the advice; and

(e) rationally believe that any financial products recommended to the recipient are suitable for the recipient; and

(f) rationally believe that following the advice would benefit the recipient.

The provider's belief is a rational one unless the belief is one that no reasonable provider in their position would hold.

SD3 Material personal interest

(1) A provider who has a material personal interest in the subject matter of the advice must give the recipient notice of the interest before or when providing the advice unless subsection (4) says otherwise.

(2) The notice must be given in writing or in some other form that can be retained by the recipient, and included in the records kept under s SD4.

(3) Without limiting subsection (1), a provider is taken to have a material personal interest in the subject matter of the advice if the advice concerns financial products issued or sold by, or other financial services provided by, the provider or an associate of the provider.

(4) A provider does not need to give notice of an interest under subsection (1) if the interest arises merely because the provider is entitled to receive a payment that is disclosed and agreed under Pt 7.7A Div 3.

Note 1: Disclosure under subsection (1) does not relieve a provider of their statutory duty under s SD2(1)(c) to act in the best interests of the recipient.

Note 2: A provider that has a material personal interest in the subject matter of the advice cannot rely on the competent provider rule in s SD2(2).

SD4 Record of advice

(1) A provider must keep written or electronic records that correctly record and explain:

(a) the instructions and information received from the recipient; and

(b) the advice provided to the recipient.

(2) The records must be retained for 7 years after the advice is provided.

(3) A recipient has a right to access the records kept under subsection (1) at all reasonable times, and to request a copy of them free of charge.

(4) A provider that contravenes subsection (1) is presumed to have contravened ss SD2 and SD3 in relation to the advice unless the contrary is proved.

(5) Paragraph (4) does not apply in relation to a contravention of paragraph (1) that is only minor or technical.

(6) A presumption under subsection (4), applying because of a contravention of subsection (1), does not have effect in so far as it would prejudice a right or interest of a person if it is proved that: (a) the contravention was due solely to someone destroying, concealing or removing records; and (b) none of those records was destroyed, concealed or removed by the first-mentioned person; and (c) the person was not in any way, by act or omission, directly or indirectly, knowingly or recklessly, concerned in, or party to, destroying, concealing or removing any of those records.