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Advice fees

Obtaining fully-informed consent

Michael Mathieson

ASIC's consultation paper on advice fee consents (CP 329 *Implementing the Royal Commission recommendations: Advice fee consents and independence disclosure*) was issued on 10 March 2020, around the time when many organisations were introducing bans on interstate travel and starting to send office-workers home.

ASIC's paper may therefore have slipped under the radar for many. If it did, then be advised: the paper sets out ASIC's proposed rules for the consent forms that will need to be used in relation to advice fees; the rules appear to have been prepared in something of a hurry; and, we should hope that the coronavirus-related delay in introducing them provides an opportunity for ASIC to reconsider and revise them.

This paper offers some explanation, and some background.

Background

The question of whether a client has consented to the enjoyment of a benefit by their financial adviser has had a long and undistinguished history.

Three cases

In *Daly v Sydney Stock Exchange* (1986), a stockbroking firm did not inform Dr Daly of its precarious financial position when it recommended that he deposit his funds with the firm, instead of using those funds (as Dr Daly had initially intended) to buy shares. The High Court concluded that the firm breached its fiduciary obligations and had failed to obtain Dr Daly's fully-informed consent to the firm's interest in the advice provided.

Justice Brennan said that an adviser who is a fiduciary has a duty 'to reveal fully the adviser's financial interest' in the subject matter of the advice.

Many years later, the Federal Court found that sellers of some very complex financial products to local councils in New South Wales owed fiduciary duties to those councils and failed to obtain the councils' fully informed consent to the sellers' interests in recommending those products—*Wingecarribee Shire Council v Lehman Brothers Australia* (2012) and *Bathurst Regional Council v Local Government Financial Services* (2012).

Ripoll Inquiry

In 2009, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) conducted an inquiry into financial products and services. In its report, the Committee said:

"The inquiry attracted considerable debate about whether banning commission-based remuneration is required to overcome the conflicts of interests it creates. Some argued that disclosure and con-

duct requirements have failed to adequately manage conflicts and a ban is now warranted, while others claimed that removing these payment methods would increase the cost and accessibility of advice for consumers. There was also discussion about whether enabling payments to be made as a percentage of funds under management represented an effective compromise between removing conflicts and maintaining affordability."

Among the PJC's key recommendations was recommendation 4. It needs to be remembered that this recommendation was made in 2009, by a multi-party Parliamentary Joint Committee, and without dissent:

"The committee recommends 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."

That's right, in 2009 parliamentarians of various political persuasions recommended that the deduction of advice fees from financial products should stop. In other words, no more advice fees paid from superannuation funds—irrespective of whether the deduction was ongoing or ad hoc, irrespective of whether it was asset-based or dollar-based, and irrespective of whether the superannuation product was a MySuper product or a choice product (a distinction that had yet to be proposed, let alone legislated). The government did consult with industry, industry did not like recommendation 4 and we got the Future of Financial Advice (FoFA) reforms instead.

FoFA, and then Hayne

Watching the development of the FoFA legislation was much like watching the proverbial sausage-manufacturing process.

The main definition of conflicted remuneration would ban advice fees, irrespective of who paid them. There would then be an exception for advice fees paid by the client. But this would not allow advice fees to be paid from a superannuation fund—as that would involve a payment by the trustee, not the fund member (so far, so good, in terms of implementing recommendation 4.)

And yet, the notion of banning the deduction of advice fees from superannuation was, in practice, regarded as unthinkable (except, apparently, by the PJC). Treasury obliged the financial advice industry, and some superannuation trustees, by stating in the explanatory memorandum that a benefit would be deemed to be given by a client if it was given by someone else but with the client's 'clear consent'. And so a rather large crack appeared in the dam wall.

ASIC was alive to the dangers presented by this particular crack. It issued guidance saying that for consent to be 'clear', it had to be 'genuine, express and specific'. Perhaps unsurprisingly, the crack was barely papered over (I still can't tell you what it means for consent to be 'genuine') and, in reality, the wall started to crumble. The mounting pressure came not just from financial advisers but also from some superannuation trustees—both were subject to the ban on conflicted remuneration and both had an interest in achieving 'clear consent'. And so the adviser remuneration section in the application forms for retail superannuation products was, in some cases, enhanced … a little.

At the same time, the ongoing fee arrangement regime commenced, requiring fee disclosure statements to be given at least annually and, in the case of post-FoFA arrangements, ongoing fee arrangements to be renewed at least every two years. 'Fees for no service' (at some point it transformed itself from a description into a phenomenon) provided a report card (that no parent would ever want to receive) on the effectiveness of those measures.

Commissioner Hayne, too, decided that ongoing fee arrangements should have to be renewed at least annually, pre-FoFA arrangements should cease to be exempted, and advice fees should not be able to be deducted … from MySuper products (and it seems a little curious that Commissioner Hayne was unprepared, in 2019, to go as far as the PJC did in 2009, and recommend an outright ban on deducting advice fees from all superannuation products).

The government agreed with Commissioner Hayne, and the exposure draft legislation released in February this year contemplates that ASIC will prescribe requirements for two client consent forms—one for an ongoing fee arrangement, and a second for an ad hoc fee proposed to be deducted from a choice superannuation product. Which brings us to ASIC's consultation paper.

Consultation paper

Consent form—ongoing fee arrangement

ASIC's proposed requirements seem to assume that this consent form will be prepared by the financial adviser. Bear in mind, though, that a superannuation trustee will not be able to deduct an ongoing advice fee from a choice product unless they receive a copy of the completed form.

ASIC proposes that the form must include 'an explanation of why the account holder's consent is being sought' (a client is now an account holder). ASIC suggests that this could be something like, 'I am seeking your consent so that I can arrange to deduct ongoing advice fees from your superannuation account'. One may query the completeness and helpfulness of such a statement.

There are also proposed requirements regarding the frequency, amount and timing of payments. And then there is a requirement that the form must include 'a warning of the benefits to which the account holder is entitled that may cease or be reduced because of deduction of the ongoing fees'. Confusing grammar aside, what does this mean? ASIC provides examples, including, 'The fees you pay for the [insert name of product] may increase if the fees make your account balance drop below [$x]'.

Well, if the advice fees cause the member's account balance to fall below $6,000, then the member may benefit from the fee cap on low account balances. One of my colleagues queried, in reasonably forceful terms, the

The quote

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The quote

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helpfulness of this requirement. I take a slightly more benign view, namely, if the requirement forces the adviser to gain a better understanding of the product from which the fees are going to be deducted, then that is not a bad thing, although it is a rather indirect way of achieving that outcome.

Stepping back from the detail, the main concern is that these requirements will not result in the adviser having 'to reveal fully the adviser's financial interest' in the subject matter of the advice. Further concerns are illustrated when the requirements for this consent form are compared with the requirements for the second consent form.

Consent form—ad hoc fee to be deducted from superannuation

ASIC's proposed requirements seem to assume that this consent form will be prepared by the superannuation trustee.

In this case, the 'name and contact details of the fund' must be included, while in the ongoing advice fee form, they are not. I get that the ongoing advice fee form may be used in circumstances other than where the fee is to be deducted from superannuation, but if a fund's name and contact details are considered important for an ad hoc fee, one would think they might also be important for an ongoing fee.

The form must also include an 'explanation of why the member's consent is being sought', although in this case, ASIC considers even greater brevity will be sufficient, and that calling the form an Advice Fee Deduction Authority would tick the box. Yet if this is truly sufficient for an ad hoc fee, it is not clear why it would be insufficient for an ongoing fee.

The form must also include information about the services that the member will be entitled to receive under the arrangement. ASIC's proposed guidance here is:

"This should explain the purpose(s) for which the cost is passed on. The requirement may be satisfied by attaching information about the advice provided."

Here, ASIC appears to be acknowledging the sole purpose test, applying to superannuation trustees. However, there is a virtually identical requirement for the ongoing advice fee form, but nothing in ASIC's associated guidance that links it, in any way, to the sole purpose test.

Again, I get that the ongoing advice fee form may be used in circumstances unrelated to superannuation, but it does seem very odd that the guidance on one form (where the sole purpose test may be less likely to be a problem) acknowledges the sole purpose test, while the guidance on the other form (where the sole purpose test may be more likely to be a problem) does not.

Postscript 1: further guidance

The consultation paper states that ASIC proposes to issue further guidance on ongoing fee arrangements, and then asks whether 'you agree with our proposal'. I went to look at the guidance so I could form a view, but it turns out the guidance has yet to be formulated—the proposal is literally a proposal to provide further guidance (which certainly makes the question a tricky one to answer).

Postscript 2: 'not independent'

Finally, ASIC proposes requirements to govern the statement to be included in a Financial Services Guide (FSG) where the providing entity is not independent, impartial or unbiased. The statement must be included on the 'first substantive page' of the FSG. And in case you were wondering what the first substantive page is, ASIC proposes to define it, and I conclude this paper by setting the definition out in all its splendour:

"first substantive page, in relation to a document, means the first page of the document that is not a cover page or a blank page". **FS**