

# REGULATORY UPDATE

ITEM 11

Centrepont Alliance Limited

September 2017

## REGULATORY UPDATES

### Summary table

Regulation	Key Requirements	Outcome
Restriction of independently owned-like terms	ASIC clarifies that terms such as 'independently owned' or similar terms are restricted under s923A.	Advisers and Licensees to remove terms 'independently owned' or like terms by 27 December 2017.
TPB registration renewals	Majority of advisers, corporates and licensees are required to renew with the TPB between July 2017 and January 2018.	Licensees need to engage with the TPB about renewing adviser registration and working toward maintaining registration status.
TPB expectation with client confidentiality	TPB clarifies that registered advisers must seek client permission to disclose to third parties, incl. licensees.	Licensees should include client 'opt-in' in the next updates of their relevant collateral (letters of engagement, client data forms, authority to proceed).
Notifiable Data Breaches Bill (now an Act)	Licensees must notify OAIC and affected clients within 30 days of becoming aware of certain data breaches.	Licensees need to develop a data breach response plan by February 2018 and train staff on new notification and authentication requirements.
ASIC industry funding levies	From Jan 2019, ASIC-registered entities will pay annual levies for ASIC's regulatory costs.	Licensees should try to estimate their levy before the invoices begin in 2019 in readiness.
AUSTRAC industry levies	AUSTRAC issued determination of upcoming levies to be invoiced and formulae to calculate.	Most advice licensees within the AAP network are unlikely to attract a levy, but should contact AUSTRAC if unsure.
AML/CTF Rules changes	Proposal to relax some customer due diligence rules, clarity around AML/CTF programs. Duplication in system to also be removed.	Awaiting AUSTRAC to communicate outcome of proposals.
Mortgage broker remuneration	Proposals to change commission basis from loan value, remove bonus payments and soft dollar, regular reporting from licensees.	Waiting to see if ASIC make any changes to permissible remuneration structures. Changes likely to be led by the banks.
ASIC Guide on Risk SoA	Sample life insurance SoA proposed by SoA with commission disclosure at beginning, advice scope at end.	Will await final guide, but as non-mandatory SoA templates may not update. Templates should have been updated in 2014 after Report 413. Focus should move now to key risk indicators.

## ITEM 11

Regulation	Key Requirements	Outcome
Dispute resolution reform	Ombudsman schemes to be merged, jurisdiction to expand, compensation caps to increase. Schemes of last resort to deal with unpaid determinations.	Awaiting confirmation of final details, likely to be later this year now that the transition team head has been announced. New system proposed to begin on 1 July 2018. Licensees will likely need to update PI insurance.
LIF Instrument finalised	ASIC Instrument confirming expected commission caps & clawback rules now issued.	Licensees should have systems in place or working toward monitoring LIF remuneration and training advisers on complying.
Professional standards update	FASEA Board appointed & CEO being recruited. FASEA office to be set up over next 6 months.	Timeframe to consultations beginning appears to be January 2019. Education & CPD likely to be first consultations.

### 1. Use of terms like “independent”

Through a media release issued on 27 June, ASIC said that it had finalised its view of the use of terms and phrases that import a perception of a financial services provider is independent, such as ‘independently owned’, ‘non-aligned’ and ‘non-institutionally owned’.

The media release said that if a financial adviser receives commissions or operates with conflicts of interest, then they will not be permitted (through the operation of section 923A of the *Corporations Act 2001*) to use the term ‘independently owned’ or other like words or expressions. ASIC said that the intention in using these terms may be largely directed toward the ownership structure of the businesses that use them, *“it is still open for these terms to mislead or confuse a consumer as to the nature of the financial service provider’s connection to the financial product issuer. In this way, these terms convey a meaning that is of ‘like import’ to the restricted terms in s923A(5)(a)(i), and so are restricted under s923A.”*

ASIC will provide a facilitative compliance period of six months to remove terms such as ‘independently owned’, ‘non-aligned’ or ‘non-institutionally owned’. ASIC will grant partial relief for members of the Association of Independently-Owned Financial Professionals (AIOFP) to indicate their association with the AIOFP provided they use clear statements that qualify any conflicts that they operate under.

ASIC is currently updating Regulatory Guide 175 to reflect the updated guidance on this issue.

**Risk:** The risk with this change in ASIC’s approach to section 923A is moderate amongst the AAP network because many licensees have been positioning themselves and creating brands and identity around being “independently-minded” and “non-institutional” for the last couple of years. Many AAP financial advisers receive risk commissions, grandfathered investment commissions or operate under some other form of conflict of interest.

Contravening s923A after 27 December 2017 will attract a fine of \$1,800 for each day, or part of a day, that an offending phrase is used. We can expect ASIC’s surveillance activities to focus on this issue during 2018 as there will be substantial pressure upon ASIC from the consumer sector, ISA-members and the IFAAA. As this is

## ITEM 11

also a win for the institutions we should also assume that the institutions will be monitoring the issue and reporting to ASIC possible contraventions.

### 2. TPB registration renewals

Tax (financial) advisers who registered with the TPB during the initial Notification Option (31/7/14 – 31/12/15) are due to renew their registration within the following six months, with those who registered in the latter part of the period due to have begun their renewals by 31 July 2017. Registrations will be renewed under the Standard Option, thereby attracting the requirement to complete subjects on Aust. Tax law and commercial law unless the adviser has at least 6-in-8 years' relevant experience in providing tax (financial) advice. There are a couple of issues with the renewals:

- Whether the registered adviser will be recognised as having sufficient experience to avoid having to complete the Aust. Tax law and commercial law subjects, and if not, whether they will have enough time to complete the subjects;
- Whether the person's 'relevant experience' providing tax (financial) advice will be recognised – as this must be substantiated in every case and cannot be inferred from experience stated on the Financial Adviser Register;
- Advisers who fail to complete their registration requirements are effectively prohibited from providing personal advice until they complete the requirements.

The renewals have also highlighted that many licensees and corporate authorised representatives need to also be registered with the TPB where they receive any remuneration associated with tax (financial) advice provided.

**Risk:** There are varying risks that AAP-licensee advisers will not complete their education requirements before their registration renewal date. Licensees need to engage with the TPB now to begin the renewal process to avoid and mitigate the risk of non-compliance.

### 3. TPB guidance on client confidentiality

In May, the Tax Practitioners Board released new guidance explaining how it expects tax (financial) advisers to comply with the TASA Code requirement to keep client information confidential (Code Item 6). The guidance essentially requires all TPB-registered advisers (and TPB-registered companies, like PIS & AW) to seek every client's specific consent to disclose their personal information to all third parties, prior to disclosure – and the guidance specifically includes licensees, product providers, paraplanners, other advisers, lawyers, licensee technical teams, and any service providers who use cloud computing in the 'third party' category. This is in direct contrast to ASIC's interpretation (and the general market's custom) that disclosure to licensees of client information is a secondary purpose under the Aust. Privacy Principles (APPs), and permitted therefore by inference from an APP-compliant privacy policy.

Code Item 6 says that "unless you have a legal duty to do so, you must not disclose any information relating to a client's affairs to a third party without your client's permission." The TPB have interpreted this as follows:

A tax (financial) adviser must ensure that they inform their clients about any client information<sup>[6]</sup> that may be disclosed. In this regard, it is recommended that the tax (financial) adviser include information in relation to whom and where the disclosure will be made. A general authority consenting to disclosure to third parties may also be acceptable.

## ITEM 11

However, even in the context of a general disclosure, tax (financial) advisers should require a positive step from their client to authorise the requisite disclosure. This may include an appropriate 'opt-in' type approach. Further, a tax (financial) adviser is not excused from taking steps to protect information just because it would be inconvenient, time-consuming or costly to do so.

The TPB says that several potential options might be used to obtain the necessary client permission, and give several practical examples to comply.

The TPB's Practice Note on Cloud Computing issued earlier in the year is consistent with this guidance, and provides specific guidance on the expected controls to maintain and protect client confidentiality.

Many licensees have not previously sought specific client permission to disclose personal information to licensees or other third parties and instead approached this from the APPs perspective that use or disclosure is permitted where an individual would reasonably expect as a secondary purpose to the primary purpose of collection – such as collection of their personal information within the Client Data Form (CDF) for the primary purpose of providing financial advice, it is reasonably expected that the CDF will be provided to the licensee who centralises the production of the Statement of Advice.

**Risk:** There is a risk that the TPB could take disciplinary action against registered individuals and companies for not seeking client consent. However, the potential for this to adversely impact the business depends on first there being a client complaint to the TPB, and then following an investigation that the TPB imposes a sanction greater than a written caution or an order requiring specific performance. The TPB is not resourced enough to undertake proactive surveillance on this issue, but this could change in future so licensees should seek to include client permissions with their next collateral updates.

## 4. Privacy Amendment (Notifiable Data Breaches) Act 2017

Licensees will be required to have a data breach response plan in place by 22 February 2018 in order to alert the Office of the Australian Information Commissioner (OAIC) and any people whose data may have been compromised where there is a data breach that is likely to result in serious harm to any individual to whom the information relates.

The last update noted that the Bill had passed Parliament in February. The Bill has received Royal Assent and is now force. Licensees need to develop their data breach response plans before February and train their staff on the changes as well as how to authenticate clients to mitigate risk of breach.

**Risk:** Potential reputational risk should a notifiable data breach occur where a licensee is required to notify clients or OAIC of a data breach.

## 5. ASIC Industry Funding Levies

On 27 June, the Government tabled the *ASIC Supervisory Cost Recovery Levy Regulations 2017*, which contain the important details about the levy types, industry subsets and definitions, levy formulae and levy component amounts. The Bill that contains the framework and its associated Collection Bill became Acts on 19 June. ASIC also released Report 535 on 14 July, clarifying the changes to the framework since the November 2016 proposals.

The main changes for advice firms are:

## ITEM 11

- the Tier 1 levy's minimum levy component of \$1,500 per licensee has been re-introduced,
- based on current adviser and licensee numbers, the cost per adviser appears to be approximately \$820/adviser, but this will change by 2019 as ASIC's annual costs and sector make up change,
- small proprietary companies (will no longer be levied through this framework but can instead expect small increases on their annual company fee (payable through the Corporations (Review Fees) Act & Regulations 2003),
- the metric for the graduated component of the credit intermediary levy (for firms also licensed as mortgage brokers) has changed from a credit advanced basis to the number of credit representatives under the licence, and
- Many advice licensees will attract the securities dealer levy, the insurance distributor levy and the wholesale trustee levy due to the respective licence authorisations to deal in securities, deal in life insurance products and deal in MIS to wholesale clients.

Invoices will be issued from January 2019 based on ASIC's costs and the industry subsector composition over the 2017-18 FY.

**Risk:** Whilst it is difficult to determine the exact cost for each entity will be in 2019 because it will be based on information collected by ASIC and costs expended by ASIC between now and January 2019, advice firms can estimate their levies. AAP will issue more detail in the coming months to assist AAP practices to estimate their levies.

## 6. AUSTRAC Industry Contribution Levies

In May, AUSTRAC consulted on the method by which it would recover its 2016-17 regulatory costs (approx. \$68m) from its regulated population. The consultation did not propose to change the thresholds for levies to be collected, being:

- An earnings component leviable from entities with >\$100m annual EBITDA, and
- A transaction component leviable from entities who receive physical or e-currency from consumers.

**Risk:** Advice licensees are reporting entities under the Act and therefore leviable entities. Unless, however, the firm has substantial group earnings over the above threshold and/or receives physical or e-currency from clients (such as in conjunction with a direct equities service or another custodial or asset management service), it is unlikely that the firm will attract a levy. If in doubt, the firm should contact AUSTRAC.

## 7. AML/CTF Rules changes

In May, AUSTRAC proposed several changes to the AML/CTF Act in response to consultation with the industry, including:

- Permitting national identity cards issued by foreign countries to be included as a type of primary photo ID and foreign equivalents of certified copies of secondary ID
- Rationalising the safe harbour and simplified verification procedures into a single simple customer due diligence (CDD) procedure
- Explicitly allowing self-attestation on a risk-based approach as a measure of last resort where a customer's identity cannot otherwise be reasonably obtained or verified
- Some changes to AML/CTF program requirements, including describing the role of AML/CTF Officers, guaranteeing the independence of a reviewer of AML/CTF programs and to require reporting entities to identify, mitigate and manage the risks posed by new technologies

## ITEM 11

- Requiring specific CDD measures be undertaken at payout time for politically exposed beneficiaries and owners of life insurance policies in circumstances of high ML/TF risk

Feedback on the proposals is currently being considered by AUSTRAC. The proposed changes to the Act have not been implemented.

AUSTRAC is currently consulting on restructuring the AML/CTF Rules to be “*simplified, rationalised and presented in a user-friendly format to improve accessibility and understanding of obligations*” without making any substantive changes to the text of the Rules.

**Risk:** Negligible risks arise from the proposed changes to both the Act and Rules. AAP will update the network when the proposed changes are implemented.

## 8. Mortgage Broker Remuneration

Following ASIC’s March issue of Report 516 on mortgage broker remuneration, Treasury consulted on ASIC’s proposals to:

- change the standard commission model to reduce the risk of poor consumer outcomes, with an example alternative being to change commission basis from loan amount to LVR or another metric;
- move away from bonus commissions, bonus payments and soft dollar benefits;
- require clearer disclosure of ownership structures within the home loan market;
- establish a new public reporting regime of consumer outcomes and competition in the home loan market; and
- improve the oversight of brokers by lenders and aggregators.

Treasury is currently considering the feedback received from the consultation.

Some of these recommendations are reflected in Stephen Sedgwick’s independent report (commissioned by the ABA) into remuneration in retail banking which recommended in April, amongst other things, that banks (whom other lenders will likely follow):

- adopt new approaches to aggregator and broker remuneration that do not directly link payments to loan size;
- cease providing volume based incentives that are additional to upfront and trailing commissions;
- improve the transparency of soft dollar payments to brokers;
- cease increasing incentives payable to brokers during sales campaigns; and
- at least the four major banks to report regularly to ASIC on conflicted remuneration and performance management issues with brokers.

Mr Sedgwick also recommended that the ABA commission a further independent review in 2019-20, which should also specifically look at whether the Government should legislate to extend ASIC’s intervention powers to address conflicted remuneration if consumer outcomes do not improve on the back of these recommendations.

**Risk:** The current risks for firms in the AAP network who also provide mortgage broking services lie with the possibility that the banks may change the basis upon which commissions are paid to brokers, which those firms receive income from. The size of the risk is difficult to determine without further details about the likely changes.

## ITEM 11

AAP will update the network when the proposed changes are implemented. Otherwise, speak with your mortgage broking association.

### 9. Life Insurance Statement of Advice Guidance

ASIC recently consulted (CP 284) on an update to Regulatory Guide 90 to provide guidance to financial advisers on a sample Statement of Advice to use for life insurance. The sample SoA prepared by ASIC is not mandatory to use; it is merely a sample for financial advisers to use.

There are substantial issues with the sample SoA, including:

- An upfront disclosure of commissions,
- Repetition prefaced on the SoA not being presented first to the client, and
- The scope of advice section near the end of the document, rather than near the beginning as is the industry custom.

**Risks:** The sample SoA presents few risks for advice licensees because it is not mandatory to use ASIC's sample format or content. The only risk lies in advisers mistakenly considering that ASIC's preferred SoA format or content is to be preferred over their licensee's and that can be mitigated with clear communication about ASIC's proposed SoA.

### 10. Dispute resolution reform

In May and June, Treasury consulted on merging the operations of FOS, CIO and the SCT into a new "one stop shop" scheme – proposed to be called the Australian Financial Complaints Authority (AFCA) – and extended the Ramsay Review's Expert Panel's terms of reference to consider whether to establish compensation schemes of last resort (CSOLR). In effect, the core proposal is to roll the CIO and SCT jurisdictions into FOS's operations. Within the AFCA proposals was draft legislation outlining that:

- The Minister will approve the new scheme's inaugural terms of reference, and ASIC will approve subsequent updates
- ASIC will have the ability to compel AFCA to change its terms of reference, including the ability to direct the scheme to increase its jurisdictional limits and compensation caps
- AFCA will be required to report to ASIC contraventions of any law, breaches of any policy terms and systemic issues, which is an expansion on FOS's current reporting obligation
- Licensees will be required to report de-identified information to ASIC about their IDR systems
- Timeliness and expertise will be added to the existing six principles that the scheme will need to comply with
- Superannuation complaints will continue to operate under most of the operative parts of the *Superannuation (Resolution of Complaints) Act 1997*
- The three existing schemes will continue to operate after AFCA is established to finalise the disputes lodged prior to AFCA's establishment

Accompanying the draft legislation was also a fact sheet that proposed to:

- Increase the jurisdictional limit for advice / investment complaints to \$1m (a 100% increase on the current)
- Increase the compensation caps for advice / investment complaints to \$500k (a 62% increase on the current)

## ITEM 11

- Remove the existing insurance sub-limits (currently \$8,300/mth for income stream claims and two that apply to general insurance claims)

The CSOLR Issues Paper sought feedback on several aspects of compensation schemes of last resort, including whether to establish both prospective scheme/s (i.e. to deal with future unpaid determinations) and a possible retroactive scheme to deal with existing unpaid determinations. The Expert Panel sought feedback on:

- The extent to which a scheme should deal with uncompensated losses – including whether to deal with decisions of tribunals and courts as well as EDR schemes – and who could lodge a claim, how such a claim should be assessed and whether the claims dealt with should be restricted to only financial advice disputes (which currently represent approx. 53% of the \$14.5m unpaid to date);
- The limits on any compensation, including whether to cap uncompensated losses or award a proportion of losses, how the compensation would be assessed for eligibility, whether legal costs could be recovered and whether litigation funders could access the scheme; and
- Which industry participants should fund the schemes, who will collect the funding, the method that annual funding levies will be calculated, how the schemes will be administered.

To assist with consideration of the issues, the Expert Panel summarised the four international schemes in place (UK, USA, EU & Canada) and the proposals put forward to date from FOS, the ABA and Westpac.

**Risk:** There are some risks for advice firms associated with both sets of proposals. It is more likely than not that the Government will establish AFCA with an increased jurisdiction and powers. What these end results will be depends on the feedback Treasury received. AAP will update the network when the proposed changes are implemented.

## 11. LIF ASIC Instrument finalised

On 5 June 2017, ASIC issued *ASIC Corporations (Life Insurance Commissions) Instrument 2017/510* which contained the transition period commission cap limits, the formula for calculating clawbacks and other clarifying aspects to the LIF reforms (such as client initiated increases during the two-year responsibility period). This is the final part of the legislative framework that underpins and facilitates the LIF reforms. The new commission caps and clawback rules will apply 1 January 2018.

**Risk:** Potential financial risks arise after 1 January 2018 if licensees who need to adapt their business models have not forecasted accurately or mitigated against potential clawbacks.

## 12. Professional standards update

There is little to report on professional standards this quarter. The standards authority (FASEA) was established – and the Board was appointed – in April. The Board had their second face to face meeting recently and appointed Dr Deen Sanders as CEO, who will then need to recruit the senior management, who in turn will recruit their respective teams. While the latter recruitment is being conducted, the senior management will likely establish the corporate policies and consultation protocols for the authority – all of which impacts on FASEA's ability to begin consulting on the standards.

Based on their respective application dates, FASEA will likely prioritise consulting on the education and CPD standards first (estimated to begin in January 2018), with the exam, professional year and Code of Conduct standards to follow.

## ITEM 11

**Risk:** There are some risks inherent due to uncertainty around the detail with some standards – for licensees the two priority areas are CPD and supervision of new advisers recruited after 1 January 2019. However, these risks can reasonably be expected to diminish as FASEA releases details about what will be required of licensees and their representatives, and licensees develop their controls and systems to accommodate any gaps.