18 March 2013

General Manager
Retail Investor Division
The Treasury
Langton Crescent
PARKES, ACT, 2600

Email: futureofadvice@treasury.gov.au

Dear Irene,

AFA Response to the Exposure Draft – FoFA Regulation on Grandfathering

Thank you for the opportunity to provide feedback on the draft FoFA Regulation on Grandfathering.

The AFA was very conscious that the legislation (and existing regulations) provided greater flexibility in terms of grandfathering than had been assumed to be the Government's objective. For this reason we understand the rationale for this regulation. Whilst we accept the need for this change and appreciate the additional timeframe that has been provided in specific circumstances, we are concerned as to the timing of this change, particularly in the context of the scale of the industry spend on complying with the FoFA obligations. We will talk further, in terms of these and other implications in our detailed response below.

Since this draft regulation was released, there has been some level of confusion in the industry as to the exact impact. For this reason, we will express, in certain sections, our understanding of the effect of the draft regulation. There has been some confusion as to whether there is a full deferral of the commencement of the conflicted remuneration obligations, which is clearly not the case.

7.7A.12EA – Buyer of Last Resort

The financial advice industry has been concerned about the lack of clarity with respect to the conflicted remuneration provisions on industry arrangements such as Buyer of Last Resort (BOLR) schemes, amongst other industry practices.

BOLR schemes, where they exist, principally provide advisers with security that they will be able to sell their business when the time comes. This is particularly important, where the sale of the business might be complicated or caused by personal health issues or economic downturn.

We recognize that the inclusion of the requirement for equivalent product multiples, across aligned product and non-aligned product, is consistent with the intent of the conflicted remuneration provisions and therefore we support this proposal.

We would like to make the point that it is often very time consuming to change agreements between a licensee and their authorised representatives (ARs), particularly where there are many

stakeholders. The consultation process and final negotiations can take many months. Thus this will pose a problem for many licensees to finalise prior to 1 July 2013. In the context of grandfathering of licensee/AR agreements, achieving the 1 July 2013 deadline is important. An alternate perspective on this is that the new provision about equivalent product multiples will only need to apply to new ARs from 1 July 2013, as the agreements with existing ARs are grandfathered. This is an issue for licensees to resolve, however the key point is that changing contracts with a large number of ARs is a very complex and time consuming exercise.

7.7A.16 – Application of Ban on Conflicted Remuneration – Platform Operator

It is our understanding that the impact of this regulation is that it will allow the grandfathering of arrangements with respect to platform operators for the following:

- Existing clients on the platform up until 1 July 2013, and
- New clients on the platform up until 1 July 2014, provided that there is an existing arrangement (pre 1 July 2013) between the platform operator and the licensee,
- The grandfathered benefits will include commission payments and volume bonuses. Commission payments will be able to continue for new clients until 1 July 2014,
- Additional investments into the platform, by existing clients, will be subject to the grandfathering arrangements.
- We also understand that movements between investment options on platforms will not impact upon the ongoing payment of commissions and volume bonuses for clients covered under the grandfathering provisions.

This now provides the clarity that was expected with respect to a cap on volume bonuses, based upon the comments made in the Minister's media release on 29 August 2011. As stated above, we have expected changes to grandfathering to limit the ongoing nature of the grandfathering of volume bonus payments. The regulation, however, adds additional complexity to the transitional arrangements. There are clearly significant implications that flow from this change that will impact the system development activity of platform operators and the FoFA project costs of licensees. We accept the policy basis for this change, however regret the delayed timing due to the likely cost to the industry and the additional confusion and complexity that has resulted.

We seek clarity that this regulation also provides for the grandfathering of benefits that flow from new clients on a platform up until 1 July 2014, where there is an existing licensee/AR arrangements and an existing Licensee or AR to employee arrangement. It may be that grandfathering as it relates to these arrangements is covered under 7.7A.16A, but it is complicated by the fact that 7.7A.16A specifically refers to non-platform business.

We would also suggest that the Explanatory Statement could more clearly explain the impact of this new regulation. It would be beneficial to clearly state that the core impact of this regulation is through the arrangements between product providers and licensees. I believe that many people are reading this from the perspective of an adviser/client arrangement and not appreciating the real impact or focus on business to business arrangements.

We note and support the section on Continuity of arrangement, which is beneficial to the financial advice industry.

7.7A.16A – Application of Ban on Conflicted Remuneration – Person Other Than Platform Operator

It is our understanding that the impact of this regulation is that it will allow the grandfathering of arrangements with respect to the following:

- New clients investing in a product up until 1 July 2014, provided that there is an existing arrangement (pre 1 July 2013) between the product provider and the licensee,
- New clients investing up until 1 July 2014, as they impact upon an arrangement between a licensee and a Corporate AR (or AR), provided that the arrangement was a pre 1 July 2013 arrangement.
- New clients investing up until 1 July 2014, as they impact upon an employment agreement between a licensee and an employee or a Corporate AR and an employee, provided that the employment arrangement was a pre 1 July 2013 arrangement.

Once again we make the point that we believe that this regulation now gives greater certainty to the limitations of the grandfathering arrangement. However, we suggest that the Explanatory Statement could more clearly explain the impact of this regulation.

We also note and recognize the sections on Continuity of arrangements, Managed investment schemes and Contributions to superannuation schemes. Each of these provide greater clarity and certainty, which is beneficial to the financial advice industry.

We would like to see specific guidance or clarity with respect to corporate superannuation, where the application might depend upon whether the retail client is considered to be the employer or the individual members.

7.7A.17 – Application of Division 4 of Part 7.7A of Chapter 7 of the Act – effect on terms and conditions of arrangement

We understand that this regulation is designed to confirm that the non-payment of a benefit under an arrangement, where the payment of the benefit would breach the obligations of Division 4 of Part 7.7A of Chapter 7, does not otherwise invalidate the arrangement. We are not certain that the proposed regulation has this intended effect, however we are supportive of the intent.

Anti-Avoidance Exposure

One of the key impacts from both the draft regulation and the recent ASIC regulatory guide on conflicted remuneration, is the importance of ensuring that arrangements are clearly compliant with the requirements of the law before 1 July 2013. The importance of this, in the context of the Anti-avoidance provisions in Section 965, is causing some level of anxiety.

The new conflicted remuneration regulatory guide has identified the importance of the avoidance of discretion in any incentive program or where benefits are being passed on. Accordingly, it will be necessary for licensees and Corporate Authorised Representatives to ensure that discretion is removed from any agreements related to benefits that are to be passed on from clients and for any volume based payments, that would otherwise be eligible for grandfathering. As mentioned above, AR agreements will need to be modified. We expect that there will need to be modifications to remuneration arrangements across a broad cross section of the financial services industry.

In our view, revising arrangements to comply with the requirements of the law and the expectations of ASIC is sensible and appropriate business. In order to address the anxiety with respect to the risk of unintentional exposure to the anti-avoidance provision, we request guidance be provided about the legitimacy of modifying agreements to ensure that they comply with the various requirements.

Other Areas Where Regulations Would be Beneficial

In commenting on this draft regulation, we would also like to address two other points of concern with respect to conflicted remuneration:

- **Corporate Superannuation.** With the interplay of the MySuper and FoFA legislation, it has become apparent that the current model and all proposed alternative models for corporate superannuation advisers, mean that it appears that they will be in breach of the conflicted remuneration obligations. Corporate Superannuation advisers provide a very valuable service in assisting employers to select a superannuation fund that is suitable for their business and providing ongoing services to the employer and the members of the fund. Whilst, in some cases an employer will agree to pay for the initial fund recommendation, it is most common that the cost of this has been recovered from the members. This will not be possible going forward, and in the context of the structure of the corporate super business and the relationship with the employer, there is no obvious solution. We request that this unintended problem be addressed through a regulation solution.
- **Passing on of Benefits are a Separate Benefit.** In their Regulatory Guide on Conflicted Remuneration, ASIC have made the point that they believe that where a benefit is passed on, it is a separate benefit and is not automatically eligible for the exemption that might have applied to the initial benefit. This needs to be viewed in the context of a payment that initiates either with the client or product provider and then flows to the licensee, from where it flows to the Corporate Authorised Representative and then on to the adviser. This means that there are three separate payments, each of which are subject to separate testing. This position has caused a great deal of confusion and uncertainty. Where the benefit is grandfathered, it is possible that grandfathering will apply separately at all three stages due to different arrangements that exist. The passing on of client directed benefits has been set out in the regulatory guide. There is less direct clarity when it comes to the passing on of life insurance related benefits, although the industry believes that this should be covered by the life insurance exemption at each of the three stages. We believe that it would be beneficial for the industry, if this was confirmed.

Conclusion

We believe that this regulation is predominantly a good outcome for the financial services industry in that it provides some level of certainty, however it will involve significant costs to implement.

Should you have any questions, please do not hesitate to contact me on (02) 9267 4003.

Yours sincerely,

Philip Anderson

Chief Operating Officer