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**Exposure Drafts - Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014 and Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014**

Thank you for the opportunity to make comments on the exposure drafts of the streamlining regulations and legislation and the accompanying explanatory statement and explanatory memorandum, respectively.

The Australian Financial Markets Association (AFMA) supports the Government's efforts to make the Future of Financial Advice (FOFA) regime operate in a more effective and efficient manner, while maintaining a high standard of investor protection. AFMA remains a strong supporter of the public policy objectives underlying the FOFA reforms.

Our comments on the draft regulations and legislation are set out below.

## 1. Paragraph 7.7A.12B(1)(a)

Regulation 7.7A.12B(1), as it is proposed to be amended by paragraphs 6 and 7 of the draft regulations, would read:

"(1) A monetary benefit is not conflicted remuneration:

(a) If the benefit is given to a provider by or on behalf of an entity in relation to [the] ~~provider dealing in~~ the [initial] issue or sale of an approved financial product issued by the entity[, on behalf of a retail client; or]

(b) if:

(i) the benefit is given to a provider by or on behalf of any entity in relation to [the] ~~provider dealing in~~ the [initial] issue or sale of an approved financial product issued by the entity[, on behalf of a retail client]; and

(ii) the provider gives the benefit, directly or indirectly, to a representative of the provider."

***"On behalf of retail clients"***

To achieve the purpose of the amendments proposed in Items 6 and 7 of the draft regulations (as reflected in the draft Explanatory Statement), the text highlighted in green above should be deleted. Retention of the references to "on behalf of a retail client" in paragraphs (1)(a) and (1)(b) would render the stamping fee exemption meaningless. Product issuers generally do not issue or sell their products on behalf of retail clients.

***"Initial issue or sale"***

The proposed inclusions of the word "initial" in paragraphs (1)(a) and (1)(b) is confusing. It suggests that the stamping fee might apply only to an issuer's first capital raising, but not to any subsequent capital raisings. (A contrary argument is that a financial product can only be issued once, and so all product issues are, by definition, "initial" issues.)

To the extent the reference to "initial" applies also to sales of financial products (ie. if the exemption applies only to stamping fees that relate to the **initial** sale of a financial product), it will <u>narrow</u> the current application for the exemption. Currently the exemption applies to all dealings in approved financial products. "Dealings" include any disposals and so are not limited to the first disposal or sale of the product.

In our experience, capital raisings offer financial products in a variety of ways. For example, sometimes a new company acquires shares in an existing company from the existing shareholder(s) and only new shares in the new company are issued to investors (this is known as a top hat structure). On other occasions, the company that carries on the existing business might issue new shares in conjunction with shares of the existing shareholder(s) being offered. In either example the existing shareholder sells their shares. The application of the word "initial" to sales will exclude from the exemption stamping fees for the sale shares in the second example if the sale of those shares is not the "initial" sale. The new shares and existing shares will be fungible and so indistinguishable and so tracking which shares attract the exemption could be challenging. Further, if the offer was instead structured as a top hat structure, the stamping fee exemption would apply to all shares offered as all shares would be issued and none sold.

There is no suggestion in the draft Explanatory Statement that the draft amendments are intended to have this impact. We submit that there is no reason to distinguish between:

- stamping fees in respect of initial issues of a class of financial products and stamping fees in respect of subsequent issues of the class of financial products; or

- stamping fees in respect of the initial sale of a financial product and stamping fees in respect of subsequent sales of the financial product.

The definition of "approved financial products" is not being amended and this limits the products covered by the exemption. In particular, except for Government issued products, the products must be or proposed to be listed on a prescribed market (or rights to acquire those products by issue). If the intention is to limit stamping fees to sales of the financial products that are in the process of changing from not able being able to be traded to being able to be traded, the exemption could be drafted accordingly.

We recommend that the word "initial" be deleted from each of paragraphs (1)(a) and (1)(b) of regulation 7.7A.12B (each reference is shaded yellow in the extracted regulation above).

***Paying to representatives***

The current wording of the stamping fee exemption arguably only permits the whole benefit to be passed on from the provider to a representative of the provider. This would not appear to make sense as providing an amount that is less than 100% to the representative would create less "influence" than providing the full 100%. To be given its proper intended operation, the provision should facilitate the passing on of a portion of the stamping fee to the representative actually advising a client on the capital raising.

The regulation should be amended to make it clear that the benefit, or a part of the benefit, can be passed to a representative from the provider.

***Typographical errors***

We have square bracketed above repeated references to the word "the" paragraphs (1)(a) and (1)(b).

**2. Subregulation 7.7A.12B(2)**

AFMA supports the repeal of the subregulation.

**3. Subregulation 7.7A.12B(3)**

AFMA supports the repeal of the definitions of "infrastructure entity", "investment entity" and "joint venture".

**4. Paragraph 7.7A.12D(1)(a) and subregulation 7.7A.12D(2)**

AFMA supports the insertion of the words "or the market known as the ASX24" and all of the associated changes to ensure that the ASX24 market is recognized for the purposes of the regulations.

**5. Regulation 7.7A.12EB**

AFMA supports the inclusion of a regulation about performance bonuses based on volume. However, in the Explanatory Statement, at Item 16 it is stated that "while not defined, a benefit is likely to be considered low if it comprises less than 10 per cent of the employee's total remuneration."

The Explanatory Statement should not make reference to a specific figure (10%) as being determinative of the significance of a bonus in an employee's total remuneration. ASIC moved away from this approach in its regulatory guidance on conflicted remuneration after industry voiced concerns about the unilateral nature of a specific figure.

Provided that remuneration arrangements are within the letter and the spirit of the law, the components of a remuneration package should be a matter for a licensee and its employees to determine. These arrangements will vary between employees, employers and across the different sectors of the financial services industry.

**6. Regulation 7.7A.12HA**

We understand that regulation 7.7A.12HA facilitates the on-payment of benefits that are calculated by reference to another benefit which is either:

(a) a non-conflicted benefit; or

(b) exempt from the conflicted remuneration provisions of Divisions 4 of Part 7.7A of the Corporations Act.

***"Permissive revenue" exemption***

Whilst the regulation is helpful and certainly welcomed by industry, we believe that there would be benefit in further clarity about the combined effect of regulation 7.7A.12HA and regulation 7.7A.16F (the "pass through" exemption"). Specifically, we are concerned that the availability of the permissive revenue exemption is unnecessarily limited only to instances where a licensee is seeking to pass on grandfathered benefits to representatives who were engaged by the licensee *prior to* 1 July 2013 ("pre-FOFA representative"). The permissive revenue exemption is therefore not available to representatives engaged *after* 1 July 2013 ("post-FOFA representative").

The reason for the inconsistency emanates from the way regulation 7.7A.16F is currently drafted. Currently, the pass through exemption provides that a benefit is not conflicted remuneration to the extent that:

(a) it is a pass through of a benefit that is received under a grandfathered arrangement ("grandfathered revenue"); and

(b) the benefit, as passed through, is given under an arrangement that was itself entered into before 1 July 2013; and

(c) the benefit, as passed through is consistent with the purpose of the arrangement under which the grandfathered revenue was paid; and

(d) the benefit passed through does not exceed 100% of the grandfathered revenue.

Assuming that parts (a), (c) and (d) are met, the problem with the pass through exemption is that it appears to only permit grandfathered revenue to be shared with pre-FOFA representatives. It does not therefore seem to operate as an extension of grandfathering – instead the sole purpose of part (c) is to restrict the circumstances in which grandfathering is available.

Although the Government recently announced amendments to the pass through exemption, the amendments do not remove the general requirement for benefits to be payable under an *existing* arrangement. To address the inconsistency of applicability between pre-FOFA representatives and post-FOFA representatives, we suggest that the Government consider removing the requirement for the benefit to be payable under an existing arrangement. Regulation 7.7A.16F would therefore read:

*Regulation 7.7A.16F:*

*A benefit is not conflicted remuneration to the extent that:*

*(a) the benefit is a pass through of a benefit (a grandfathered benefit ) to which Division 4 of Part 7.7A of Chapter 7 of the Act does not apply because of subsection 1528(1) or (3) of the Act or a regulation made for subsection 1528(2) of the Act; and*

~~*(b) the benefit, as passed through, was given under an arrangement that was entered into before the application day, within the meaning of subsection 1528(4) of the Act; and*~~

*(c) the benefit, as passed through, is consistent with purposes of the arrangement under which the grandfathered benefit was paid; and*

*(d) the total amount of the benefit, as passed through, does not exceed 100 per cent of the grandfathered benefit.*

Consequently, unless regulation 7.7A.16F is amended to remove the restriction, it will significantly restrict the ability of a licensee to pass through a share of grandfathered benefits under proposed the permissive revenue exemption. The inconsistency not only creates unnecessary duplication of effort for licensees but also adds further to the compliance costs of operating in a FOFA-compliant environment.

## 7. Paragraph 961B(2)(g)

AFMA supports the repeal of the paragraph.

## 8. Substituted subsection 963B(3)

The inclusion of 'personal advice' in relation to 'products of that class' introduces some uncertainty regarding the meaning of this exemption.

For example, a client may use a cash management trust (CMT) to settle financial product transactions and the licensee/adviser will not provide a personal advice recommendation to acquire units in the CMT. However, the licensee/adviser can and does provide personal advice recommendations to acquire units in products of the same class as the CMT – for example, an Australian equities managed fund.

It is not clear whether the licensee/adviser is prevented from relying on this exemption to receive a benefit in relation to the CMT if it provides personal advice on managed funds, even if it never provides personal advice in relation to the CMT.

Clarification on this issue would be helpful.

## 9. Fee disclosure statements

Some AFMA members are concerned about the different disclosure requirements that will apply, depending on whether a customer entered into an arrangement pre or post 1 July 2013, and the associated cost burden for licensees that may result.

The draft amendments remove the requirement to provide a fee disclosure statement (FDS) to retail clients where their ongoing fee arrangement was entered into before 1 July 2013. An FDS must still be provided to retail clients where their ongoing fee arrangement was entered into on or after 1 July 2013.

This amendment is not sufficient to achieve the Government's aims of reducing compliance costs, particularly for smaller industry participants.

A licensee needs to make the same investment in processes and IT software development to produce FDSs for a handful of new retail clients as it would to produce FDSs for all its retail clients. As the draft amendments significantly reduce the number of clients to whom an FDS must be issued (by around 90% for some licensees) the same dollar of investment becomes an extremely inefficient use of limited resources.

Some AFMA members are of the view that the provision of an FDS provides no additional benefit to their retail clients. Due to the nature of the ongoing fee arrangements entered into with retail clients, some members believe that the current suite of reports provided to clients on an annual basis adequately discloses the sum of fees clients pay under those arrangements.

The original FOFA reforms were introduced with the purpose of giving retail clients greater control over the fees they pay through annual fee disclosure and fee renewal every two years.

If this is still a valid policy outcome for FOFA, then repealing the opt in requirements and excluding the majority of existing retail clients from the FDS requirement renders the policy ineffective as, in the main, retail clients receive no consumer protection from what remains of these measures.

**10. Inconsistences between the brokerage fee exemption and the stamping fee exemption**

Some AFMA members have identified inconsistencies between the brokerage fee exemption and the stamping fee exemption, and inconsistent outcomes for licensees who outsource to third party clearing participants.

The operation of the brokerage fee exemption is such that where a brokerage fee (as defined by subregulation 7.7A.12D(2)) is received by a licensee **AND** passed through to a representative, the brokerage fee is exempt from the conflicted remuneration ban. Effectively, this implies that the treatment of the brokerage fee in the hands of the licensee is dependent on what the licensee then does with the benefit – ie:

- If it passes it through, the exemption applies and the benefit is not conflicted remuneration; but
- If it retains the benefit or its representative is remunerated some other way (for example the pass through is not payable until certain thresholds are met) the benefit remains conflicted remuneration.

In Regulatory Guide 246, ASIC requires that each leg of a transaction between parties needs to be assessed against the law individually on its own merits. However, the current operation of the exemption contradicts this approach.

Further, the construction of the exemption is inconsistent with that of the stamping fee exemption which has two prongs and allows for the possibility that stamping fees may not be passed through to representatives – ie:

- First prong - benefits received by a licensee from the issuer are not conflicted remuneration; and
- Second prong - benefits received and passed through to a representative are not conflicted remuneration.

Where a brokerage fee is not passed through, as contemplated by the brokerage fee exemption, other exemptions may be available - for example, where personal advice was given, the client paid exemption. ASIC has laid out in Regulatory Guide 246 strict conditions for the application of the client paid exemption. These conditions will be reinforced by the proposed addition of a note at section 963A.

In more complex circumstances where the licensee outsources clearing and settlement activities to a third party clearing participant (clearer), it is difficult for these conditions to be met. In an outsourcing arrangement with a clearer, brokerage fees are physically passed from the client through the clearer to the licensee. Some AFMA members are concerned that the current nexus of standard terms and conditions signed by clients and the clearing agreements signed with the clearer do not provide sufficient evidence of the client's clear consent as required by ASIC and by the proposed amendments. In order to apply the client paid exemption, some licensees have produced a second agreement to document the client's authorisation for brokerage fees to be passed through from the clearer to the licensee, in situations where there is no pass through to the retail client's adviser.

The additional compliance burden arising from the described outsourcing arrangement has the effect of disadvantaging smaller licensees who use third party clearers, versus those licensees with in-house clearing capability.  Equity can be restored by amending the brokerage fee exemption so that it operates in a manner consistent with the stamping fee exemption.

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Please contact me on 02 9776 7997 or tlyons@afma.com.au if you have any queries about this letter.

Yours sincerely

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