Lander & Rogers
Lawyers

21 February 2014

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

Our ref: RST:2021211
Office: Sydney

By email: futureofadvice@treasury.gov.au

Dear Sir or Madam

PROTECTING THE LIVELIHOOD OF FINANCIAL PLANNERS

A CALL FOR AMENDMENTS TO THE CORPORATIONS ACT TO REMOVE UNNECESSARY RESTRICTIONS ON BUSINESS STRUCTURES

This submission is made by Synchronised Business Services Pty Ltd (**Synchron**) and Lander & Rogers.

Synchron is Australia's largest independently owned financial advice group with around 300 representatives Australia wide.

Lander & Rogers is a leading independent Australian law firm operating nationally from Melbourne and Sydney. The firm has a market leading financial services team providing a full range of legal services to the financial sector.

Introduction

We welcome the Federal Government's proposed amendments to the Future of Financial Advice (FOFA) legislation and regulations under the *Corporations Act 2001* (Cth) (**Act**), many of which are designed to alleviate some of the costs associated with the regulation of the financial planning industry, while retaining core consumer protections. These amendments further support the transformation of the financial planning industry into a profession.

We applaud the initiative of the Government and Treasury to deliver affordable and accessible financial advice through amendments to the FOFA legislation, and are

Sydney
Level 19, Angel Place
123 Pitt Street
Sydney NSW 2000
Australia
DX 10212
Sydney Stock Exchange NSW
T +61 2 **8020 7700**
F +61 2 8020 7701
www.landers.com.au
ABN 58 207 240 529

Melbourne
Level 12, Bourke Place
600 Bourke Street
Melbourne VIC 3000
Australia
GPO Box 1842
Melbourne VIC 3001
Australia
DX 370
Melbourne VIC
T +61 3 **9269 9000**
F +61 3 9269 9001

encouraged by the Government's goal of ensuring that Australians have affordable access to a well-functioning financial advice market.

There is, however, in our view one aspect of the current legislative regime that requires urgent reform but is not addressed in the exposure drafts of the proposed amending legislation[1] and regulations[2].

The law as currently applied and interpreted by ASIC imposes a particular business structure on financial planning firms which puts at risk the remuneration of financial planning practices by unnecessarily requiring them to be structured as part of the business operations of the dealer group whose Australian financial services licence (**AFSL**) stands behind the services they provide.

This is unduly restrictive and exposes the financial planners to risks over which they have no control.

We believe the law can be amended to overcome this problem without disturbing the overall regime for the supervision of the financial planning industry.

Section 911A(2) - AFSL exemption for representatives

Under the Act as it currently stands, a person carrying on a financial services business in Australia must hold an AFSL[3]. There are, however a number of exemptions to this requirement.

Relevantly, Section 911A(2) provides as follows in respect of exemptions to the obligation to hold a AFSL under the *Corporations Act 2001 (Cth)*:

"s 911A Need for an Australian financial services licence

> *(2) However, a person is exempt from the requirement to hold an Australian financial services licence for a financial service they provide in any of the following circumstances:*
>
> > *(a) the person provides the service as representative of a second person who carries on a financial services business and who:*
> >
> > > *(i) holds an Australian financial services licence that covers the provision of the service; or*
> > >
> > > *(ii) is exempt under this subsection from the requirement to hold an Australian financial services licence that covers the provision of the service;*
>
> ***Note**: However, representatives must still comply with section 911B even if they are exempted from this section by this paragraph."*

Significantly, the AFSL holder (**Licensee**) is responsible to clients of the representative for all conduct relating to the provision of financial services[4], and as such is the focus of ASIC's supervision and oversight of the industry.

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[1] *Corporations Amendment (Streamlining of Future of Financial Advice) Bill* 2014
[2] *Corporations Amendment (Streamlining of Future of Financial Advice) Regulation* 2014
[3] s. 911A(1), *Corporations Act 2001* (Cth)
[4] s. 917A, *Corporations Act 2001* (Cth)

ASIC Regulatory Guide 36 also provides the following comments[5] regarding the interpretation of whether a person is a "representative" for the purposes of relying on the aforementioned exemption under section 911(A)(2):

> *"In order to determine whether the exemption from the requirement to hold an AFS licence in s911A(2)(a) applies, you need to consider whether you are acting as a principal or as a representative of a principal. The exemption applies only if you are acting as a representative of a principal.*
>
> *You may be acting as a principal and not as a representative if:*
>
> *(d) client assets are held in an account in your name;*
>
> *(e) clients are directed to pay any fees owing for the provision of financial services to you or into an account in your name;*
>
> *(f) if you receive commissions directly from product issuers; and*
>
> *(g) you have ownership of, access to, or liability for, client information."*

In practice, financial advisory firms typically adopt a structure whereby the financial planners operate as authorised representatives (**ARs**) of a Licensee. Commercially, each AR operates as a separate business. However, in conducting that business, it relies on the Licensee to provide support, assistance and oversight to ensure that advice and other financial services are provided in a way that complies with the Act, recognising that the Licensee is considered legally responsible for the financial services provided by the AR. The arrangements in many respects may resemble a franchise arrangement.

Reflecting the requirement in s911A that the AR act "as representative" of the Licensee, the Licensee, rather than each AR, will typically contract with the approved product providers (**Providers**) as principal and accordingly, the Licensee, rather than each AR, holds the benefit of the commercial relationship with the Providers. Under this structure, illustrated in Annexure A (**Existing Structure**), the Provider will pay fees, commissions and other amounts relating to services provided by the ARs to the Licensee, and there are then separate contracts between the Licensee and each AR, under which the Licensee pays a portion of the revenue received from the Provider to the AR.

By adopting the structure described in Annexure A, the ARs are not required to hold their own AFSL by virtue of section 911A(2).

Existing structure exposes ARs to unnecessary business risks

Under the Existing Structure, ARs receive fees and commissions for their services (being the provision of financial services in relation to the Provider's approved financial products to investors) directly from the Licensee. This arrangement is designed to ensure that the AR can satisfy the requirement to provide financial services "as representative" of the Licensee, having regard, in particular to ASIC Regulatory Guide 36 which suggests that if an AR were to receive fees and commissions directly from a Provider or from a client (including where the Provider collects a payment made by the client), it is likely to be considered to be acting as a "principal" rather than a "representative" and therefore not meet the requirements of the AFSL exemption.

An undesirable side-effect of the Existing Structure arises where a Licensee is placed in liquidation and its ARs are left unable to recover unpaid fees and commissions which are due to them. This seems an unfair outcome given that the AR will have provided the relevant

[5] At paragraphs RG 36.93 and 36.94

services to clients, and the Provider and the AR's clients will have paid for those services by making a payment to the Licensee. Creditors of the Licensee will compete with the AR for payment of the amounts which the AR has earned through the conduct of its business. The AR is required to be a creditor of the Licensee if it wishes to rely on the exemption from licensing contained in section 911A(2)(a) of the Act.

There are several recent instances of this occurring. These include the collapse of AAA Financial Intelligence in early 2013 owing ARs a reported $300,000, and the collapse of Australian Financial Services which was formally wound up in May 2013 with losses to ARs reported as $1.5 million.

If ARs could be permitted to receive fees and commissions direct from Providers and clients while still relying on the section 911A(2) AFSL exemption, this would lessen the likelihood of ARs being left out of pocket for unpaid fees and commission upon the liquidation of Licensees.

As a general point, we think that Licensees and ARs should be free to adopt whichever business structures suit their commercial circumstances and this should not be restricted by the Act. The Act need only prescribe the liability regime applicable to Licensees and ARs and the "representative" concept should be limited in its application to addressing the supervision and liability regimes prescribed by the Act.

The growing independence of ARs

ARs are, in many cases, the primary providers of financial advice to consumers. Their position in the financial services industry as a first point of advice and sales is vital to ensuring Australians have affordable access to a smoothly functioning financial advice market. We believe it is important that ARs are free to perform their services without facing the significant financial risk of being unable to recover payment should their Licensee be placed into liquidation.

We believe that the law should be reformed to allow ARs to operate as separate businesses from the Licensees they represent, while retaining the legislative requirement that the Licensee is responsible to supervise the ARs in providing financial services, and remains legally responsible for the financial services provided by the AR.

In particular, the Act should allow a structure whereby ARs, while continuing to rely on the section 911A(2) exemption, can receive fee and commission payments directly from Providers, such as the structure set out in Annexure B. For administrative convenience, we expect that Licensees would act as agent for the ARs in contracting with the Providers and collecting and remitting payments due to each AR. The difference, however, would be that the payments made by the Provider in relation to services rendered by an AR would belong to the AR and not to the Licensee.

Importantly, however, allowing Licensees and their ARs to adopt this structure without altering the liability regime in the Act would not erode the consumer protection provided by the Act for clients of the Licensee and its ARs.

Under the Act and ASIC Regulatory Guide 36 RG 36, the arrangement in Annexure B would likely result in the AR being deemed a "principal" rather than a "representative" and therefore falling outside the AFSL exemption.

Recommendations

In order to enable ARs to receive payments directly from Providers without the need to obtain a AFSL, we submit that amendments should be made to section 911A of the Act as set out in Annexure C.

We believe that these amendments are of vital importance in seeking to reform the financial planning industry and remove barriers to entry.

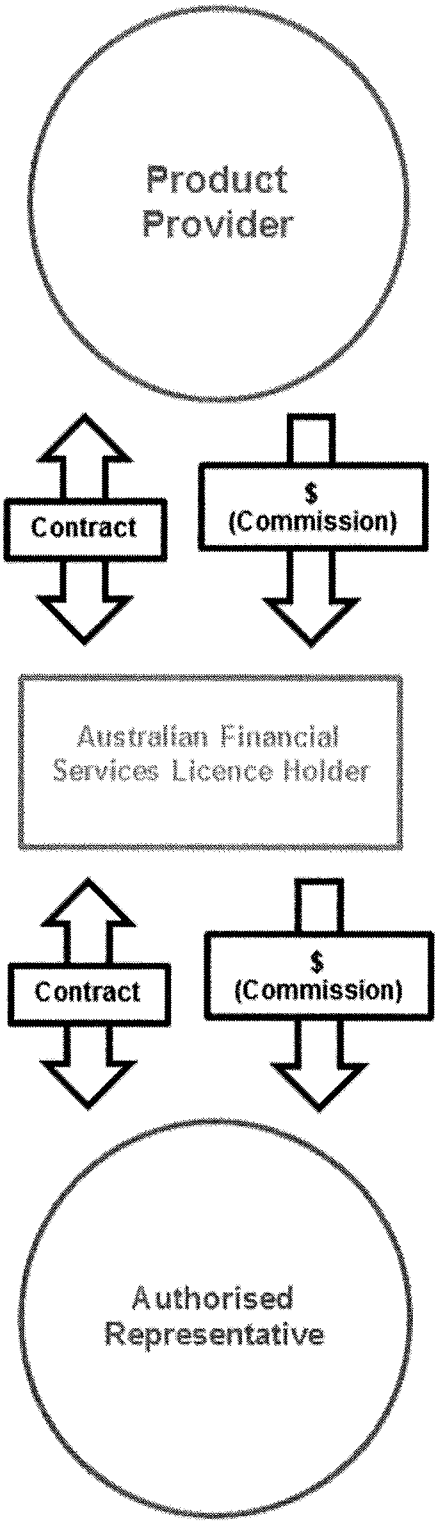
We are happy to discuss any aspect of this submission and we look forward to continuing to be able to participate in consultation on important policy issues affecting the financial planning industry.

Yours sincerely

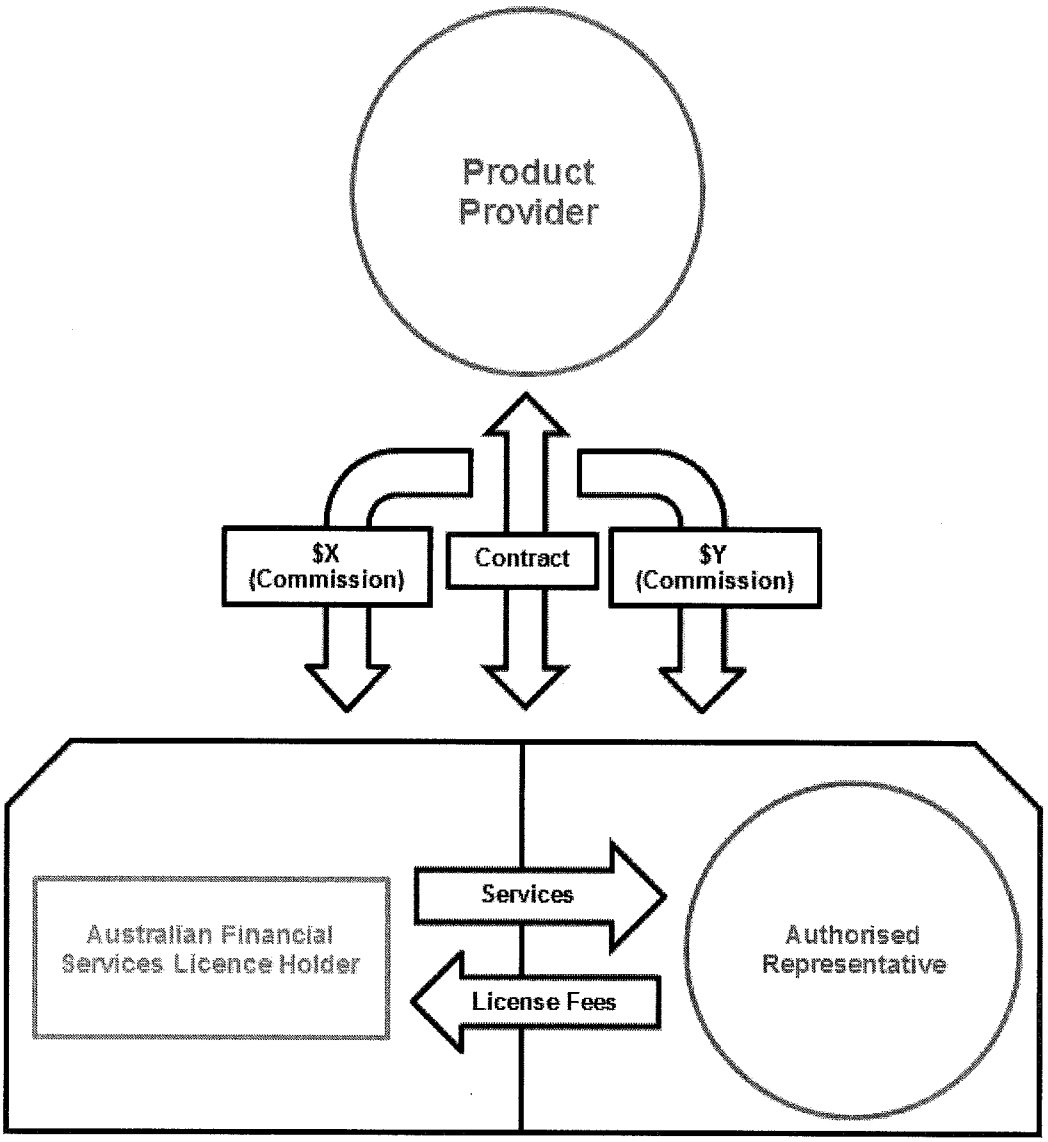
Lander & Rogers
Ruth Stringer | Partner
D +61 2 8020 7661
rstringer@landers.com.au

Synchron
John Prossor | Director and Compliance Manager
D + 61 3 9328 8933
j.prossor@synchron.net.au

ANNEXURE A
EXISTING STRUCTURE



ANNEXURE B
PROPOSED NEW STRUCTURE



ANNEXURE C
SECTION 911A: PROPOSED AMENDMENTS
(proposed amendments highlighted)

911A Need for an Australian financial services licence

(1) Subject to this section, a person who carries on a financial services business in this jurisdiction must hold an Australian financial services licence covering the provision of the financial services.

Note 1: Also, a person must not provide a financial service contrary to a banning order or disqualification order under Division 8.

Note 2: Failure to comply with this subsection is an offence (see subsection 1311(1)).

(2) However, a person is exempt from the requirement to hold an Australian financial services licence for a financial service they provide in any of the following circumstances:

(a) the person provides the service as representative of a second person who carries on a financial services business and who:

(i) holds an Australian financial services licence that covers the provision of the service; or

(ii) is exempt under this subsection from the requirement to hold an Australian financial services licence that covers the provision of the service;

Note: However, representatives must still comply with section 911B even if they are exempted from this section by this paragraph.

.....

(2A) For the avoidance of doubt:

(a) references to a person providing services as a representative of the holder of an Australian financial services licence mean that the Australian financial services licence holder is responsible for the supervision of the representative in the provision of those financial services and that the that the Australian financial services licence holder accepts liability for those financial services in accordance with the liability regime established under this Act;

(b) a person can be a representative of the holder of an Australian financial services licence for the purposes of the Australian financial services licensing regime even if they are conducting a separate business from the business conducted by the holder of the Australian financial services licence for whom they are acting as a representative;

(c) the fact that a person acts as a representative of the holder of an Australian financial services licence does not mean that the person is an agent of the holder of the Australian financial services licence; and

(d) a person who acts as a representative of the holder of an Australian financial services licence may enter into commercial relationships in their own right with providers of financial products and with the clients to whom the person provides financial services in connection with financial services provided in that capacity.