MinterEllison | LAWYERS

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General Manager
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Attention: Richard Sandlant

Dear Sir/Madam

Exposure Draft - Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (Tranche 2 Bill)

Minter Ellison is a full service commercial law firm which provides legal services to clients in a variety of industries and sectors, including the financial services industry and the wealth management sector of that industry. Our clients include fund managers, insurance companies, investment platform operators/other administrators and financial planning dealer groups. Accordingly, we believe we are well placed to provide valuable, balanced insights on the potential consequences of the draft FOFA legislation.

We appreciate the opportunity to provide comments on the Tranche 2 Bill. Our comments are provided in three parts:

(a) In the first part of this letter, we provide high level comments on the Tranche 2 Bill.

(b) In the second part, we provide some additional commentary in relation to the version of the Corporations Amendment (Future of Financial advice) Bill 2011 (**Tranche 1 Bill**), tabled for first reading on 13th October 2011, notwithstanding the process for public comment and consultation in relation to that bill has now closed. We believe that there are some important aspects of the Tranche 1 Bill which require further discussion and clarification.

(c) The schedule to this letter includes a table of more detailed comments on certain provisions of the Tranche 2 Bill.

Tranche 2 Bill

Our major concerns with the Tranche 2 Bill are:

1. The conflicted remuneration prohibition in Division 4 is too broad and does not focus sufficiently on the types of remuneration that have real potential to create conflicts for advisers in the industry. The ban should not generally apply to general advice – it should be confined to situations where a retail client is dealing with an adviser in a one-on-one situation, such as a meeting or telephone call. By casting the ban as broadly as proposed,

the Government will make it very difficult to provide any meaningful incentives for advisers to grow their business. This in turn will make it difficult to attract individuals of the calibre required to provide quality advice to clients.

2. The prohibition on payments that can be made by product issuers should mirror the ban on conflicted remuneration that licenses and representatives can receive. The present inconsistent bans will create uncertainty and expense for the industry without any accruing consumer benefit. A blanket prohibition of the sort proposed in s.964 is not appropriate.

3. The proposed anti-avoidance prohibition is too broad. Anti-avoidance measures should be targeted at the specific measures proposed rather than imposing a new uncertain Part IVA style regime on the industry.

4. The shelf space fee ban extends beyond the measures announced by the Government. In part, this seems an unintended consequence of the broad nature of the definitions used which extend well beyond fund managers and investment platforms to include insurance companies and any means of obtaining information about investments. We also note however that there is no limitation on the ban to situations where the benefit is passed through to licensees (ie. advice licensees) and representatives as originally proposed.

5. The exceptions for insurance remuneration are too narrow. They should not be limited to payments from insurance companies and the superannuation exception should not be limited to individual policies.

6. Despite assurances from the Minister in relation to the ‘grandfathering’ of existing ongoing commissions and platform volume arrangements (see 29 August 2011 media release), the relevant provisions allowing for ‘grandfathering’ are absent from the draft legislation. The prospect of grandfathering is raised in passing (and in a different context) at paragraph 1.17 of the Explanatory Memorandum, but the concept is not elaborated. To allow industry participants to gear up for the changes with effect from 1 July 2012, we submit that the Government should announce its proposed measures for ‘grandfathering’ promptly.

7. Both of the Tranche 1 and Tranche 2 Bills propose very significant changes for the industry. These changes will require a significant investment in both time and cost to implement the changes. New compliance procedures and systems will need to be developed, existing product and advice related software will need substantial modification to accommodate the new conduct and disclosure requirements and to ensure that the remuneration prohibitions can be implemented and every adviser will need to undertake significant levels of training on the new requirements. All of this will take considerable time. As the Minister has indicated that the legislation is unlikely to become law until early 2012, industry will need a transition period of at least 18 months from that time to be able to make all the changes required. We submit therefore that the commencement date for all measures should be deferred until no earlier than 1 July 2013.

We have set out further details of our concerns regarding these and other issues in the schedule to this letter.

Tranche 1 Bill

Potentially greater coverage of ongoing fee arrangements

The definition of 'ongoing fee arrangement' is broader than in the Exposure Draft of the Tranche 1 Bill, and arguably picks up ongoing commissions in relation to products recommended before 1 July 2012. This is the case because an ongoing commission is likely to be an arrangement entered into in the context of an adviser providing personal advice to a retail client, and, under the terms of the arrangement, the adviser is paid a fee (however described or structured) during a period of 12 months or more.

This is relevant only to the fee disclosure obligation (and not to the renewal and other requirements affecting post 1 July 2012 ongoing fee arrangements). We suspect that application of the fee disclosure regime in this way to 'grandfathered' commissions would be an unintended consequence of the drafting (and, as such, an inappropriate erosion of the 'grandfathering' benefit), so we submit that this problem should be addressed.

However, the broader point is that the fee disclosure requirements now extend to ongoing fee arrangements which were entered into before 1 July 2012. If enacted, this by itself, would be a significant erosion of the 'grandfathering' principle. In this regard, we submit that the position should be reversed so that the legislation reflects the position in the Exposure Draft of the Tranche 1 Bill.

Some confusion remains around 'grandfathering' (s.962D)

There has been an attempt to clarify grandfathering of existing arrangements. The effect of s.962D appears to be that a pre-1 July 2012 client will be 'grandfathered' from the opt-in requirement, and can be serviced by all representatives in a licensee group after 1 July 2012 on that basis, if the licensee enters into the ongoing fee arrangement and the licensee or any of its representatives has provided personal advice to the client before 1 July 2012. Presumably this allows client servicing rights to be transferred amongst advisers within a dealer group after 1 July 2012 without triggering the opt-in obligation. If this is correct (and clarification is respectfully sought), then it provides a useful concession which will facilitate succession planning within dealer groups.

However, where a representative (and not the licensee) enters into an ongoing arrangement, 'grandfathering' will only apply if ***that*** representative or their licensee has provided personal advice to the client before 1 July 2012. The practical consequence of this provision is that any client who is charged for advice before and after 1 July 2012 on the basis of an ongoing commission ('grandfathered'), and who is allocated to a new adviser, will become a renewal client if the new adviser signs the client up on the basis of an ongoing fee after 1 July 2012. The same client would be 'grandfathered' from the opt-in requirement if the ongoing fee arrangement were signed directly with the licensee who could simply pass servicing rights down to the new adviser. This appears somewhat anomalous.

The Tranche 1 Bill also fails to clarify the position as regards the assignment after 1 July 2012 of any existing ongoing fee arrangement. Where such an arrangement is assigned to a new licensee or to an adviser in a different dealer group, is it intended that the arrangement be 'grandfathered' on the basis that (strictly speaking) it was entered into between the original parties before the commencing day of the legislation (see s.962D(1)(b)), or does there need to be commonality between the fee recipient and the provider of the pre-commencing day advice? The Explanatory Memorandum (at paragraph 1.59) appears to give the fee recipient a discretion to determine whether or not the full renewal and disclosure provisions will apply to the acquired book. However, we submit that objective certainty is essential in this context and giving the fee recipient an ill-defined discretion without guiding parameters is likely to result in sub-optimal outcomes.

Exemptions and modifications

We note that unlike other parts of Chapter 7, Part 7.7A does not contain any power for either ASIC or regulations to make exemptions from or modifications to the Part. Given the complexity of the proposed regime and the significant potential for unintended consequences as highlighted by the various submissions that have been made in respect of both Tranche 1 and Tranche 2 of the FOFA legislation, we strongly recommend that exemption and modification powers based on ss.951B and 951C be included in Part 7.7A.

We also believe that ASIC should be given an express power to exempt particular arrangements from:

- the definition of conflicted remuneration;
- the prohibition on the provision of benefits by issuers and sellers in s964;
- the application of the prohibition on volume-based shelf-space fees;
- the application of the prohibition on charging asset based fees on geared funds; and
- the definition of ongoing fee arrangement.

Please let us know if you would like to discuss any of the issues we have raised in this or our previous submission.

Yours faithfully
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Our reference:

Exposure Draft
Corporations Amendment Further Future of Financial Advice Measures) Bill 2011
Detailed comments

	Section	Subject matter	Issue
1.	963-963H	Ban on commissions	Nowhere does the draft legislation seek to define 'commission'. We believe that this is a fundamental flaw in the drafting given that embedded commissions are precisely the target of the policy underlying the FOFA reforms. In our opinion, the oblique approach taken in banning any form of remuneration (whatever its provenance) which *might influence* product recommendations or financial advice, could result in a number of acceptable forms of remuneration, extraneous to the client/adviser relationship, being challenged. Our concern is not overcome with the finite list of carve-outs in ss.963A and 963B. By failing to tackle commissions head-on and with more explicit language, we are concerned that the risk of unintended consequences is increased.
2.	963(1)	Conflicted remuneration – 'might influence'	The problem noted above is exacerbated by the absence of any requirement for impugned remuneration to be *reasonably likely* to influence advice. While introducing such a requirement would involve a move away from the presumption that all payments or benefits received by licensees or representatives are conflicted, we believe that ample protection is afforded by the ban on payments by product issuers to licensees and representatives under s.964(1). The introduction of a 'reasonably likely to influence advice' test would provide greater certainty to those who are actually providing the advice to clients.
3.	963(1)	Conflicted remuneration – general advice	We submit that the application of the ban on conflicted remuneration to general advice as proposed in the Tranche 2 Bill is too broad. While we acknowledge that where advice is being given directly to a retail client in a meeting or telephone call the ban should apply whether the advice is personal advice or general advice. However, it is not necessary or appropriate for the ban to apply to generally available material which is not directed to an individual client.
4.	963(2)	Profit share and balanced scorecard remuneration	Each of the three limbs of s963(2) use the phrase 'is dependent on' which creates uncertainty as to the degree of dependence required. We submit that volume based remuneration should only be banned where it is solely or principally dependent on the value or number of investments or products. This would assist to ensure that profit-share arrangements, which are quite appropriately a key method of incentivising advisers in the financial sector and in other professions, are not banned. The concern is otherwise that any profit or revenue

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			sharing arrangement will be banned to the extent that profit or revenue relates to funds under advice which is likely to be the case where an advice business derives most of its revenue from client-agreed fees based on the value of their investment portfolio. We also believe that an express carve-out for profit and revenue-sharing arrangements should be included in s.963A(1) to remove any doubt that these types of arrangements are permitted. Our suggested approach would also assist where an adviser is remunerated through a 'balanced scorecard' bonus arrangement. We submit that bonus arrangements should be permitted where the value or amount of investments is not the principal determinant for whether a bonus will be paid. It is increasingly common for bonus schemes to focus on compliance and quality of advice outcomes and where these are the main determinant for assessing whether a bonus is payable and the amount payable, we believe it should be possible to include a measure relating to the adviser's contribution to the financial success of the business which is likely to involve some element relating to the adviser's client base and therefore funds under advice.
5.	963(2)(a)	Total value of financial products	We are uncertain what is meant by this phrase used in s.963(2)(a) or how it differs from s.963(2)(c).
6.	963A(1)(a) and (b); 963B(1) (a); 964(2)(b)	Insurance related benefits	The exceptions for insurance commission and other benefits in ss.963A(1)(a) and (b), 963B(1)(a) and 964(2)(b) all require the benefit to be given by the insurer. This effectively means that insurance related benefits received by a licensee cannot be passed on to other licensees or to representatives. This conflicts with the Government's stated policy intention in relation to insurance commissions and other remuneration. We therefore submit that the reference to the insurer should be removed from these provisions. We also note that the reference to 'general insurer' as defined by the *Insurance Act 1973* appears to exclude payments of commission by Lloyds syndicates and associated parties. This problem applies to ss. 963A(1)(a), 963B(1)(a) and 964(2)(b) We also submit that it is not appropriate to differentiate between individual and group policies in the manner proposed. Where a client is advised to obtain cover in addition to the default level of cover within a superannuation fund, it should be possible for the adviser to receive commission for the cover recommended in the same way that the adviser can receive commission for individual life insurance taken within or outside superannuation. Otherwise, there will not be level playing field between these different types of cover and there will be a risk of market distortions occurring.
7.	963A(1)(c)	Non-advice related	We welcome the fact that the Government has sought to provide an express exemption for remuneration linked to

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		remuneration	activities other than advice. However, we submit that this exemption is too narrow and will not operate as intended. One problem with s.963A(1)(c) is that it will not apply whenever the licensee or representative or any of their associates has at any time in the past given any financial product advice to the client. There needs to be a link between the advice given and the subsequent dealing activity otherwise this exemption may never apply. It is highly likely that every client will have received some form of at least general advice from a licensee, whether in the form of published material in brochures or reports on on the internet or in the course of attending a seminar or in some unrelated discussion with a representative of the licensee. This problem can be addressed by making it clear that the exemption applies unless it is reasonably apparent that the issue or sale (subject to our comments below) occurs as a result of financial product advice given to the client by the licensee or representative. We also submit that the exemption should not be limited to the issue or sale of financial products but should extend to other dealing activities and to unregulated activities such as administration.
8.	963A(1)(d)	Client agreed asset based fees	While s.963A(1)(d) attempts to carve out remuneration agreed directly between client and adviser (which is one of the central policies underlying the FOFA reforms), the draft legislation should be clarified so that asset based fees agreed with a client, and which happen to be paid through an investment platform, are not treated as *conflicted remuneration*. The problem is that s. 963A(1)(d) is drafted in terms of a benefit *given* by a retail client. Where advice fees are funded from a client's portfolio (e.g. as a result of a client direction to the operator to deduct the fees from the client's investment), the benefit is not really *given* by the client, even where the client has agreed to this charging method.
9.	963B(b)(ii)	Soft dollar limit	As regards the anti-avoidance exception to the small benefit carve-out, we believe that the reference to similar benefits being provided 'on a frequent or regular basis' may lead to confusion and possibly arbitrary enforcement proceedings. An aggregate annual measure and/or a test to catch conduct structured to fall within the terms of the carve-out (but which, in substance, is an abuse) would be better. Alternatively, if 'frequent or regular' is not defined, it would at least be useful for the Explanatory Memorandum to include examples of what is and is not deemed to be 'frequent or regular' for certainty. For example, presumably taking a representative out to lunch once a year would not be 'frequent or regular'.
10.	963B(c); 964(e)	Education and training	We believe that the restrictions foreshadowed in the Explanatory Memorandum in relation to professional

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		benefits	development events sponsored by product issuers are matters more appropriately dealt with through industry self regulation and practice guidelines. We believe that industry bodies are better equipped than government to get the detail right in this area. Accordingly, the Financial Services Council, the Financial Planning Association and other industry bodies should be given the opportunity to develop a model code covering event sponsorship by product issuers. We are also concerned about the relevance test in ss.963B(c)(ii) and 964(e)(ii). If there are any concerns about particular types of training we submit that this could be addressed in industry codes or if necessary the regulations. We are concerned that advisers are engaged in a range of activities beyond advice. Not only do they engage in dealing activities such as arranging for investments to be made and for trades to be placed, they also undertake administrative activities for clients and there is a range of training that may be relevant to the business of a financial adviser but which may not necessarily be viewed as 'relevant to the provision of financial advice' such as training relating to equal opportunity, occupational health and safety training, running a (small) business and marketing.
11.	963B(d); 964(f)	IT software and support	We do not believe that the benefits permitted by ss.963B(d) and 964(f)should be limited to financial products issued or sold by or of the benefit provider. Other licensees also need to provide benefits to their representatives. We also believe that the benefit should not be limited to 'the provision of financial product advice' in part for the reasons noted above. However, the problem is even more acute in relation to this exception as any software or IT support is likely to relate to systems to facilitate advisers to access the issuer's product and to arrange for it to be issued to their client or to implement changes to product options which activities will not of themselves relate to the provision of financial advice
12.	963B	Arms-length terms	To avoid any uncertainty, we believe that the legislation should contain an exception for benefits provided to licensees and representatives on arms-length terms at fair market value.
13.	963C	Limited carve-out for employee remuneration	Section 963C provides a carve-out from the ban on *conflicted remuneration* for certain monetary and non-monetary payments to employees. For the carve-out to operate, the remuneration must either be: • provided by an authorised deposit-taking institution (**ADI**) solely for basic banking products, or

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			• consideration for services provided or to be provided as an employee, and must not constitute volume based benefits. *Volume based benefits* are of the type covered in s.963(2). As the reference point for *volume based benefits* is the value or number of financial products or investments *of a particular kind or particular kinds* recommended by the representative, presumably it should remain open to employers to continue paying employed advisers bonuses which are referable to profits provided that they are not calculated directly and solely by reference to product sales. For the reasons noted above, we believe that this point would benefit from clarification and more explicit treatment. There is also no express carve-out for *volume based benefits* payable to employed insurance (life or general) advisers even though receipt of risk commissions from insurers will generally be allowed to continue. Without such an express carve-out, any employer (e.g. a licensee or a corporate authorised representative) which pays an employed risk adviser a share of commissions received will be in breach of s.963H - a proposed civil penalty provision - which prohibits employers from paying *conflicted remuneration* to employees. For consistency of approach with the payment of risk commissions, we would suggest that this gap be addressed. We also note that the banking exception should not be limited to ADI employees. In the first place, many corporate groups use a separate service company as the employer for group employees. Furthermore, we submit that level-playing field considerations mean that the exemption should be available to banks and others alike.
14.	963F	Employed authorised representatives	As noted in our previous submission, employed authorised representatives are treated differently to employees of licensees. We submit that employees should not be subject to civil penalty prosecution whether they are employed by a licensee (when they do not need to be an authorised representative) or by a corporate authorised representative (when they do).
15.	963G and 963H	Representative defences	We note that a representative who is not an authorised representative does not have the defence provided by s.963F(2) in s.963G. While we acknowledge that this provision does not give rise to a civil penalty, it may give rise to a banning order by ASIC and we submit it should therefore be subject to the same defence. Similarly, we believe that the prohibition on employers making payments in s.963H (which is a civil penalty provision) should also be subject to a defence where the employer is not the representative's licensee and has received information about the benefit from the licensee regarding the

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			nature of the benefit.
16.	964	Product issuer prohibition	We do not understand why the prohibition on product issuers providing benefits is not the mirror image of the prohibition on accepting conflicted remuneration. We submit that a product issuer should only be prohibited from providing remuneration that a licensee or representative cannot accept under Division 4. In other words, they should be prohibited from providing conflicted remuneration as defined in Division 4. Any other outcome will simply create uncertainty and produce results where a licensee or representative can accept remuneration which cannot be provided or vice versa. The breadth of the prohibition in s.964 will cause problems for numerous different payments that may flow between a product issuer and licensee, including: • intra-group payments • payment of premiums to a licensed insurer by another licensed product issuer such as a superannuation trustee (it is not obvious that a premium should be characterised as a 'fee for service') • insurance profit share arrangements to licensees involved in underwriting or claims management • payment of claims by an insurer to a licensed superannuation trustee • payment of client agreed fees from a platform or fund – how will the operator know whether the fee 'reasonably represents the market value of the service'? We note that the Explanatory Memorandum states that a comprehensive prohibition ensures that ASIC can identify payments which have the potential to distort advice. However, we do not believe that it is appropriate to cause such uncertainty and expense for the industry. We support principles based regulation and therefore submit that the legislation should clearly set out the principles governing the banning of payments as the definition of conflicted remuneration seeks to do in Division 4. This is the appropriate approach for both those receiving benefits and those paying them. Furthermore, we note that at the very least ASIC should have an express power to make exemptions from s.964(1) (see our earlier comments on exemption and modification powers).
17.	964(2)(a)	Fee for service exemption	In s.964(2)(a), it is not clear whether the service for which the fee is paid (and which would be exempt from the prohibition in s.964) is the provision of financial advice by the licensee/representative to the end client, or some other service unconnected with the client/adviser relationship, and provided by the licensee or representative to the product issuer. If the former, then it is not clear why a fee arrangement expressly agreed between the client and adviser should be subject to a

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			statutory market value test (in addition to the fee disclosure and renewal requirements covered in the Tranche 1 Bill). If not the former, then this again emphasises the need for a more specific provision allowing payment of asset-based fees from client portfolios.
18.	964(2)	No soft dollar limit	The s.964 prohibition on product issuers also fails to exempt 'soft dollar' benefits below the prescribed threshold of materiality (in contrast to the carve-out in s.963B). If left this way, this would create the rather anomalous situation of advisers being entitled to receive immaterial 'soft dollar' benefits, but product issuers being prohibited from providing them unless they fell under one of the more specific exemptions in s.964(2) or were otherwise saved by the regulations.
19.	964A	Ban on volume based shelf space fees	Subdivision B in Division 5 of the Tranche 2 Bill seeks to impose a ban on volume payments by *funds managers* to *platform operators*. The Minister's 28th April 2011 media release indicated that such payments would only be prohibited where passed on to licensees, so this provision goes further than many were expecting. In fact, the ban is difficult to understand as a *platform operator* is defined not only as someone who provides a facility through which investment products are issued but also as a facility through which licensees and advisers can obtain information about financial products or through which any financial product is issued. This seems to mean that the ban extends to purely administration services and product research facilities as well as to benefits provided by licensees who are not fund managers such as insurance companies.
20.	964B	Volume-based shelf-space fee	V*olume-based shelf-space fee* is defined broadly. The definition carves-out discounts and rebates of amounts paid by the platform operator to the funds manager. However, any such rebate or discount must not exceed the reasonable value of scale efficiencies obtained by the *funds manager* as a result of the volume of its products issued through the relevant platform. The wording in s.964B(1)(b) may be misconstrued. Taken literally, it is difficult to conceive of a situation where 'a discount on an amount payable, or a rebate of an amount paid, by the *platform operator* to the *funds manager* for services provided by the *funds manager* to the *platform operator*' might arise in the context of a platform distribution arrangement, so we submit that clarification of this language is required. We also submit that the requirement in s.964B(2)(b) will be difficult for a fund manager to assess. It essentially makes ASIC and the courts an arbiter of the commercial value of 'scale efficiencies'.
21.	965	Anti-avoidance measures	We submit that the anti-avoidance measures proposed are much broader than they need to be and will create significant uncertainty for industry and stifle innovation and therefore

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			efficiency which will ultimately disadvantage consumers. We note that many of the proposed measures have embedded anti-avoidance measures (for example the anti-avoidance exception to the small benefit carve-out in s.963B(b)(ii) and the application of the geared funds prohibition in s.964F where it is reasonably apparent that the funds are borrowed). We believe that it is more appropriate to incorporate specific anti-avoidance measures where relevant rather than a blanket ban of the nature proposed in s965, especially considering that it is a civil penalty provision. If the ban is retained as proposed, it would greatly assist industry if Treasury could comment and provide guidance on whether private label product arrangements promoted by advice licensees after 1 July 2012 would be likely to contravene the anti-avoidance provisions in s.965. The types of arrangement we have in mind include an investor directed portfolio service (IDPS) or IDPS-like scheme where the licensee or a related entity is the operator or responsible entity, or a superannuation master trust where the licensee or a related entity is the RSE-licensee. Typically, such arrangements would be operated by the licensee as principal (and, in that respect, would differ from 'white label' arrangements where the licensee merely controls branding), but administration would be outsourced to an appropriately licensed and qualified service provider. We submit that whatever the purpose for such a proposal it should not be subject to the measure as it will artificially limit innovation and competition in the industry. Where such proprietary product arrangements can deliver benefits to clients (e.g. cost savings, product customisation, integration with other systems and ease of use by advisers), any conflicted perception of purpose is not relevant.