EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer

Corporations Act 2001

Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014

Subsection 1364(1) of the *Corporations Act 2001* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* makes a number of amendments to the *Corporations Regulations 2001* (the Principal Regulations). The amendments relate to the Future of Financial Advice (FOFA) provisions in Part 7.7A of the Act.

As part of the 2013 election, the Government committed to reduce compliance costs for the financial services industry. Specifically, the Government committed to implement the recommendations of its *Dissenting Report to the Parliamentary Joint Committee on Corporations and Financial Services* inquiry into the Bills that introduced the FOFA provisions, as well as make other further changes to reduce compliance costs for the financial services sector.

The proposed Regulation supports the changes to the FOFA legislation.

The proposed Regulation makes changes by:

- broadening the circumstances when the grandfathering arrangements for the ban on conflicted remuneration apply;
- clarifying what benefits can be paid under a balanced scorecard arrangement;
- exempting bonuses paid in relation to 'permissible revenue';
- clarifying the application of the stamping fee exemption to capital raising activities and broadening its application to include investment entities;
- amending the application of the existing brokerage fee exemptions to include brokerage fees paid in relation to financial products traded on the ASX24;
- ensuring that the wholesale and retail client distinction that currently applies in other parts of the Act also applies in respect of the FOFA provisions; and
- clarifying the operation of the ‘mixed benefits’ provisions.

Details of the proposed Regulation are set out in Attachment A.

The Government has also announced that time sensitive FOFA amendments will be dealt with through regulations and then locked in to legislation.

To the extent possible under the primary legislation, the proposed Regulation will also make interim changes until the Corporations Amendment (Streamlining of Future of Advice) Bill 2014 passes the Australian Parliament and receives Royal Assent. These changes will:

- remove the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the 'opt-in' requirement), from when the proposed Regulation commences until 31 December 2015;
- remove the requirement to provide an annual fee disclosure statement to clients in ongoing fee arrangements prior to 1 July 2013, from when the proposed Regulation commences until 31 December 2015;
- remove the 'catch-all' provision from the list of steps an advice provider may take to satisfy the best interests obligation, from when the proposed Regulation commences until 31 December 2015;
- facilitate the provision of scaled advice;
- clarify the meaning of ‘intrafund advice’;
- clarifying the operation of the 'mixed benefits' provisions; and
- amend the application of the ban on conflicted remuneration including:
  - exempting general advice;
  - exempting monetary benefits paid in relation to certain life risk insurance offerings inside superannuation;
  - amending the exemption for execution-only services to provide that only advice provided by the party receiving the benefit is considered;
  - broadening the exemption for training and education that relates to operating a financial services business; and
  - broadening the existing exemption for basic banking products to allow an agent or employee of an authorised deposit-taking institution to access the exemption in a broader range of circumstances.

As outlined above, the proposed Regulation will mirror the changes to the primary legislation to the extent allowed under the regulation-making powers in the Act. For the purposes of consultation, please provide comments on the draft legislative amendments.

Incorporating these amendments into this Regulation will provide certainty to industry until the primary legislation can be put in place, and the amendments repealed following commencement of the Corporations Amendment (Streamlining of Future of Advice) Bill 2014.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The *Corporations Act 2001* does not specify any conditions that need to be satisfied before the power to make the Regulation may be exercised.

This Regulation commences the day after it is registered.

Attachment A

Details of the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014*

Section 1 – Name of Regulation

This section provides that the name of the Regulation is the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014.*

Section 2 – Commencement

This Regulation commences on the day after it is registered.

Section 3 – Authority

This Regulation is made under the *Corporations Act 2001* (the Act).

Section 4 – Schedule(s)

This section provides that Schedule 1 amends the *Corporations Regulations 2001* (the Principal Regulations).

Schedule 1 - Amendments

Wholesale/retail client distinction

The amendments in Items 1, 2, 3, 4 and 5 serve to extend the effect of a number of regulations which currently apply to Parts 7.6, 7.7, 7.8 and 7.9 of the Act to Part 7.7A of the Act.

The amendments are consequential and provide that an Australian financial services licensee or representative can treat a person as a wholesale client in Part 7.7A of the Act where the person meets certain specified criteria set out in section 9 or section 761G of the Act.

Item 1 – Subsection 761G(7) of the Act specifies certain situations in which a client is not considered to be a retail client in circumstances where the financial product is not, or a financial service provided to the client does not relate to, a general insurance product, superannuation product or retirement savings account product.

Regulation 7.6.02AB acts to insert into subsection 761G(7) of the Act paragraph 761G(7)(ca) for the purposes of Parts 7.6, 7.7, 7.8 and 7.9 of the Act.

Paragraph 761G(7)(ca) adds an additional criterion to the criteria of who is not considered to be a retail client. The additional criterion is that where a product or service is acquired by a company or trust controlled by a person who meets the requirements of 761G(7)(c)(i) or (ii), the company or trust is not considered to be a retail client.

Regulation 7.6.02AB amends Item 1 so that paragraph 761G(7)(ca) also applies for the purposes of Part 7.7A of the Act.

Item 2 – Regulation 7.6.02AC acts to insert into section 761G of the Act subsections 761G(7A) and 761G(7B) for the purposes of Parts 7.6, 7.7, 7.8 and 7.9 of the Act.

Subsections 761G(7A) and 761G(7B) add additional criteria to the criteria used to determine if a client is a retail client at paragraph 761G(7)(c). The additional criteria enable the person to include in their net assets or income for the purposes of qualifying to be treated as a wholesale client, the net assets and gross income of a company or trust they control.

Regulation 7.6.02AC amends Item 2 so that subsections 761G(7A) and 761G(7B) also apply for the purposes of Part 7.7A of the Act.

Item 3 – Regulation 7.6.02AD acts to insert into section 761G of the Act subsection 761G(4A) for the purposes of Parts 7.6, 7.7, 7.8 and 7.9 of the Act.

Subsection 761G(4A) states that where a financial product or service is acquired by a body corporate as a wholesale client, related bodies corporate of the client are considered to be wholesale clients.

Regulation 7.6.02AD amends Item 3 so that subsection 761G(4A) also applies for the purposes of Part 7.7A.

Item 4 – Regulation 7.6.02AE acts to substitute paragraph (e) of the definition of professional investor at section 9 of the Act for the purposes of Parts 7.6, 7.7, 7.8 and 7.9 of the Act.

Paragraph (e) of the definition of professional investor set out in section 9 provides the criterion that a person is considered to be a professional investor if they control assets of at least $10 million including any assets held by an associate or under a trust that the person manages. Regulation 7.6.02AE substitutes paragraph (e) to provide for a person to be considered to be a professional investor where the person has or is in control of gross assets of at least $10 million including any assets held by an associate or under a trust that the person manages.

Regulation 7.6.02AE amends Item 4 so that the change in the definition of professional investor provided by 7.6.02AE also applies for the purposes of Part 7.7A of the Act.

Item 5 – Where a person elects to be treated as a wholesale client rather than a retail client, paragraph 761G(7)(c) of the Act enables the person to acquire an accountant's certificate which certifies that the person's assets or income are large enough to qualify them as a wholesale client.

Paragraph 761G(7)(c) of the Act requires that the accountant's certificate be renewed at least every six months. However, Regulation 7.6.02AF acts to extend the renewal period for accountants' certificates from six months to two years for the purposes of Parts 7.6, 7.7, 7.8 and 7.9 of the Act.

Regulation 7.6.02AF amends Item 5 so that the extension of the renewal period for accountants' certificates from six months to two years also applies to Part 7.7A of the Act.

Stamping fee exemption

The amendments in Items 6, 7, 8 and 9 relate to the exemption from the ban on conflicted remuneration for 'stamping fees' provided under regulation 7.7A.12B.

Subregulation 7.7A.12B(1) provides an exemption for certain benefits relating to capital raising activities ('stamping fees') from the ban on conflicted remuneration in circumstances where a licensee or representative ('providers') receive the benefit in relation to their dealing on behalf of a retail client in an 'approved financial product' (as defined under subregulation 7.7A.12B(3)). Subregulation 7.7A.12B(2) limits the exemption so that it does not apply in relation to capital raising activities relating to certain types of entities whose primary purpose is to provide a financial investment.

Item 6 – amends paragraph 7.7A.12B(1)(a) and clarifies the requirement that a provider must be considered to be 'dealing on behalf of a retail client' in an 'approved financial product' to provide that the exemption applies where the benefit is given to the provider in relation to the 'initial sale or issue' of an 'approved financial product'.

Specifically, Item 6 omits references to the 'provider dealing in' and substitutes the words 'initial issue or sale of' in paragraph 7.7A.12B(1)(a).

Item 7 – amends subparagraph 7.7A.12B(1)(b)(i) to omit references to the 'provider dealing in' and substitute the words 'initial issue or sale of'.

This amendment has the same effect as Item 6, except that this subparagraph relates to the passing on of a benefit by providers to their representatives.

Item 8 – removes subregulation 7.7A.12B(2) which excludes a benefit paid in relation to an 'investment entity' from the exemption from the ban on conflicted remuneration for 'stamping fees' provided under subregulation 7.7A.12B(1).

An 'investment entity' is defined under subregulation 7.7A.12B(3) as an entity which provides a return to its shareholders (or members) mainly from either an investment in financial products or in owing real property (other than for the purposes of developing the property), but does not include an 'infrastructure entity' (as defined under subregulation 7.7A.12B(3)).

The effect of this amendment is that 'stamping fees' will be able to be paid in relation to capital raising activities in respect of investment entities.

Item 9 – amends subregulation 7.7A.12B(3) to omit the definitions of ***infrastructure entity***, ***investment entity*** and ***joint venture***. This amendment is a consequential change resulting from Item 8.

Stockbroking-related exemptions

Items 10, 12 and 14 – amend the application of certain brokerage-related exemptions from the ban on conflicted remuneration in relation to products traded on the ASX24.

Regulation 7.7A.12D states that a monetary benefit is not conflicted remuneration where the benefit is a brokerage fee given to a provider who is a trading participant of a 'prescribed financial market' and the provider gives the benefit to a representative of the provider.

While the ASX24 (the financial market operated by Australian Securities Exchange Limited, formerly known as the Sydney Futures Exchange) is not a market included in existing regulation 1.0.02A as a 'prescribed financial market', the trading that occurs on the ASX24 is not intended to be subject to the conflicted remuneration provisions of Division 4 of Part 7.7A of the Act. Nor are brokerage fees charged for trading on the ASX24 intended to be subject to the ban on charging asset-based fees on borrowed amounts under Division 5 of Part 7.7A of the Act.

The amendments at Items 10, 12 and 14 provide for brokerage fees in relation to products traded on the ASX24 to be eligible for the existing exemptions from the bans on conflicted remuneration and on charging asset-based fees on borrowed amounts currently provided to brokerage fees relating to products traded on a 'prescribed financial market', such as the ASX Limited.

Specifically, Item 10 inserts into paragraph 7.7A.12D(1)(a) the words 'or the market known as the ASX24' to ensure that the ASX24 is included as a financial market when a monetary benefit is received by a representative of a provider who is a trading participant so that the monetary benefit is not considered to be conflicted remuneration.

Items 11, 13 and 15 – clarifies which market the ASX24 is by inserting notes into subregulation 7.7A.12D(2) that provide details about the ASX24. That is, the ASX24 is the financial market operated by Australian Securities Exchange Limited, formerly known as the Sydney Futures Exchange.

The current note in subregulation 7.7A.12D(1) and the current note at end of the definition of brokerage fee in subregulation 7.7A.12D(2) are repealed and reinserted by Items 11 and 13 with the addition of a numbered note, due to two notes about the ASX24.

Item 12 – 'Brokerage fee' is defined in subregulation 7.7A.12D(2) as a fee a retail client pays to a provider who deals in a financial product traded on a prescribed domestic or foreign financial market. Item 11 inserts in subregulation 7.7A.12D(2) at 7.7A.12D(2)(aa) the words, 'the market known as the ASX24; or', to ensure that the brokerage fees paid in relation to trades on the ASX24 fall under the definition of a 'brokerage fee' and are a monetary benefit that is not considered to be conflicted remuneration and are also a 'brokerage fee' which is exempt from the ban on charging asset-based fees on borrowed amounts pursuant to Regulations 7.7A.17 and 7.7A.18.

Item 14 – Similar to the insertion by Item 10, Item 14 inserts into the definition of 'trading participant' in subregulation 7.7A.12D(2) the words, 'or the market known as

the ASX24', to ensure that a trading participant of the ASX24 is included in the definition of 'trading participant'.

Balanced scorecard remuneration arrangements

Item 16 – inserts a new regulation 7.7A.12EB to provide when certain performance bonuses based on volume are not conflicted remuneration. The regulation describes what is commonly referred to as benefits paid under a 'balanced scorecard arrangement'. A balanced scorecard remuneration arrangement exists where an employee receives remuneration that is calculated by reference to both volume-based and non-volume-based factors.

Under the regulation, a monetary benefit is not conflicted remuneration if:

- the benefit is given to, or for, an employee of the provider (the definition of 'provider' is given in regulation 7.7A.12); and
- the benefit is an element of the employee's remuneration; and
- the value of (or access to) the benefit is partly dependent on the total value of financial products of a particular class, or particular classes, that are recommended by the employee or acquired by clients to whom the employee has provided advice; and
- the financial products in the class or classes are not financial products to which any of the following applies (that is, products that are not already exempt from the ban on conflicted remuneration):
  - paragraph 963B(1)(a) of the Act (general insurance products);
  - paragraph 963B(1)(b) of the Act (life insurance products within the meaning of that paragraph);
  - section 963D of the Act (basic banking products); and
  - regulations made for the purposes of paragraph 963B(1)(e) of the Act; and
- the benefit is low in proportion to the employee's total remuneration;
- in calculating the benefit, the weighting attributed to the total value of financial product is outweighed or balanced by the weighting attributed to other matters; and
- if the benefit, or part of the benefit, relates to personal advice provided to a retail client, the part of the benefit that relates to personal advice is given in circumstances that is likely to encourage the giving of personal advice that is in the client's best interests.

While not defined, a benefit is likely to be considered low if it comprises less than 10 per cent of the employees total remuneration.

Permissible revenue

Item 17 – inserts a new regulation 7.7.12HA which provides that a benefit is not conflicted remuneration where the amount or value of the benefit is calculated by reference to another benefit that is not considered conflicted remuneration. This may be in reference to a benefit that:

- does not fall within the definition of 'conflicted remuneration' in section 963A of the Act;
- is specifically exempted from the ban on conflicted remuneration; or
- is not subject to ban on conflicted remuneration because of the grandfathering arrangements provided in subsection 1529(1) or regulations made for subsection 1529(2).

This form of benefit is commonly referred to as 'permissible revenue'.

Mixed benefits

Item 18 – repeals regulation 7.7A.12I and substitutes a new regulation which provides for the treatment of 'mixed benefits'. Mixed benefits are multiple benefits which are paid together. The new regulation 7.7A.12I provides that a benefit does not become conflicted remuneration purely because it is paid together with another benefit. In other words, a benefit cannot be deemed as conflicted remuneration purely because it is a mixed benefit. Note: this amendment will also be made through legislation, at which point the regulation will be repealed.

Grandfathering arrangements for the ban on conflicted remuneration

Items 19 to 23 – make amendments to the grandfathering arrangements. The grandfathering arrangements provide that certain benefits given under arrangements (typically between product issuers and licensees) entered into prior to the application day of the ban on conflicted remuneration and that relate to clients who had interest in the relevant platform or product prior 1 July 2014 are not subject to Division 4 of Part 7.7A of the Act.

Item 19 – inserts a new subregulation 7.7A.16A(5A) to clarify that when a business is sold (and that business is acting in the capacity of a platform operator), the rights to the grandfathered benefits are transferred to the purchaser, who can then receive the ongoing benefit. The purchaser may therefore acquire the same rights to the grandfathered benefits that the seller held prior to the sale taking place.

Item 20 – inserts a new subregulation 7.7A.16B(4A) which has the same effect as Item 19, except that this subregulation refers to the sale of businesses which are not acting in the capacity of a platform operator.

Item 21 – inserts a subregulation 7.7A.16B(5A) to provide that when a retail client elects to switch from the growth phase to the pension phase within the same superannuation interest, this will not be treated as the acquisition of a new financial product for the purposes of regulation 7.7A.16B. This will allow grandfathered benefits to continue to accrue where the client held the superannuation interests prior to 1 July 2014 and made the election after this date.

Items 22 and 23 – amend existing regulation 7.7A.16F to provide that the requirement in paragraph 7.7A.16F(b) does not apply when:

- an authorised representative of one licensee becomes an authorised representative of another licensee after the application day of the ban on conflicted remuneration;

- a representative (for example, an employee) of a financial services licensee becomes an authorised representative of the same licensee.

Attachment B

REGULATION IMPACT STATEMENT

An options-stage regulation impact statement (RIS) has been prepared in accordance with the Office of Best Practice Regulation (OBPR) guidelines. The RIS has been published on the website of OBPR and can be accessed at: http://ris.finance.gov.au/2014/01/13/future-of-financial-advice-amendments-options-stage-regulation-impact-statement-department-of-the-treasury/

Impact: The amendments to FOFA will affect businesses and consumers within the financial services industry.

Main points:

- The amendments to the FOFA legislation seek to fulfil the Government's election commitment, so no alternative policy options have been considered as a part of the RIS.
- The proposed FOFA amendments are deregulatory and have been designed to reduce the compliance burden on the financial advice industry. Firms within the industry are expected to benefit through a reduction in red tape and compliance costs.
- Preliminary estimates, based on industry consultation, of the direct ongoing cost savings are approximately $190 million per year; one-off implementation cost savings are approximately $90 million.
- Consumers are expected to gain access to more affordable and accessible financial advice as lower costs to industry are passed through to consumers.