Stockbrokers Association of Australia
Incorporating SDIA

13 July 2012

Ms Irene Sim
General Manager
Retail Investor Division, Markets Group
THE TREASURY
Langton Crescent
PARKES ACT 2600

Dear Ms Sim,

FOFA: Conflicted Remuneration
- the 'no-advice' exception in s963B(1)(c)

During our recent meeting in Canberra, we mentioned an issue in relation to the **'no-advice' exception to the ban on conflicted remuneration** in section 963B(1)(c) of the FOFA amendments to the *Corporations Act*[1].

As discussed, we would like to provide more detail of the issue with the aspect of the 'no-advice' exception. Section 963B(1)(c) of the *Act* (as amended) sets out circumstances where monetary benefits are not taken as conflicted remuneration. It states -

> **963B Monetary benefit given in certain circumstances not conflicted remuneration**
> (1) Despite section 963A, a monetary benefit given to a financial services licensee, or a representative of a financial services licensee, who provides financial product advice to persons as retail clients is not conflicted remuneration in the circumstances set out in any of the following paragraphs:
> …
> (c) each of the following is satisfied:
> (i) the benefit is given to the licensee or representative in relation to the **issue or sale** of a financial product to a person;
> (ii) **financial product advice in relation to the product, or products of that class, has not been given to the person as a retail client by the licensee or representative in <u>the previous 12 months</u>**; *(emphasis added)*

[1] As enacted by the *Corporations Amendment (Further Future of Financial Advice Measures) Bill* 2012

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Since our meeting we have now had the benefit of seeing the draft **Stockbrokers Carve-outs**[2] which were released on 16 June for consultation. While the Carve-outs will be of great benefit to stockbrokers, there will be occasions where they will not apply, for example where advice is given on an unlisted product.

We would therefore like to better understand the two limbs of the s963B(1)(c) exemption, namely -

(a) why it only applies to a situation where a financial product is being **issued or sold** to a person, and
(b) why the **12-month requirement** was applied late in the process, without the opportunity for industry comment.

Why does the exception only apply to issues or sales of financial products?
The exception only applies to situations were a financial product is being 'issued or sold' to a person. This would cover recommendations to a client to buy a financial product, whether on the primary (e.g. IPO) or secondary (e.g. ASX listed) market. It would not appear to extend to recommendations to sell, or hold, financial products.

Why the 12-month requirement?
The 12-month requirement was added in the 22 March 2012 amendments when the Bill passed the House. Previously there was no time limit. There is no explanation in the Explanatory Memorandum to the Bill as to why it was added so late in the process, or to the no-advice exception in general.

One of the objectives of FOFA was to encourage **'scaled advice'**[3]. We very much support this objective, since it acknowledges the reality that clients do not always seek 'holistic' advice over their entire investments and situation. Often – and more often than not in stockbroking - they only need specific, product-based advice over a share or a portion of their assets.

There are two main scenarios in stockbroking, personal (scaled) advice and execution-only / no-advice:

- *Personal (scaled) advice*: here, a client may just want a view on the stockmarket in general and certain stocks in particular, with a view to buying, holding or selling them. **This is very common in stockbroking.** A client in this scenario would clearly be receiving personal advice, albeit **'scaled advice'**.

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[2] *Corporations Amendment Regulation* 2012 [Third package] Draft June 2012

[3] The expression 'scaled advice' is used in the Note to s961B(2)(g) – i.e. the obligation to take '…any other step that would reasonably be regarded as being in the best interests of the client'. The Note states:

> *Note: The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.*

- *No-advice / Execution-only*: the other scenario is where clients do not require advice. They make up their own minds to buy or sell securities, and ring their stockbroker to execute the transaction, in so called **'execution-only' or 'no-advice' trading**.

Normally, remuneration models for full service firms do not differentiate between advisory and execution-only trading. Accordingly, as is contemplated by the Stockbrokers Carve-outs, the adviser will earn a split of brokerage on the transaction for both advisory and execution-only client trades.

A problem will arise therefore, in the execution-only context if, during the previous 12 months, personal advice *has* been given. This is despite the fact that there is no nexus between the previous advice and the current 'no-advice' transaction. We fail to see the rationale for this conclusion, and why it is at all relevant to later transactions where no advice is given.

Conclusion

At its heart, FOFA aims to remove conflicts of interest where financial product advice, particularly personal advice, is given to retail clients. Where there is no advice, then the best interests and conflicted remuneration requirements are not relevant. Uncertainty surrounding the 'no-advice' exception of s963B(1)(c) is at risk of confusing the situation considerably.

We do not have the benefit of detailed explanatory materials on these FOFA amendments. Therefore, in order to provide certainty, and remove any conflict with the Stockbrokers Carve-outs, **we request more explanation as to the rationale and intended operation of the 'no-advice' exemption in s963B(1)(c).**

Timing will soon become critical on this matter. Obviously, we are now in the 12 month transition, but this issue will crystallize as firms elect to become 'FOFA-compliant' (as several firms are) over the next few months.

Thank-you once again for seeing us recently in Canberra, and for your staff's time in considering this and other FOFA issues. We would be happy to meet with you to discuss the issue further at your convenience. Should you require further information, please contact me, or Doug Clark on dclark@stockbrokers.org.au .

Yours sincerely,

David W Horsfield
Managing Director/CEO