

[Draft 1: 13 October 2011]



Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011

Submission

October 2011

Executive Summary *[To be finalised]*

The Stockbrokers Association notes that it is most unfortunate that this Bill will see the implement of the **prohibition model** on **conflicted remuneration**, when in this industry the current **disclosure model** has not been proved to be in need of replacement.

We welcome the announcements of the **Stockbrokers Carve-outs**, namely the exclusion from the definition of *conflicted remuneration* of **Stamping Fees** on capital raisings and **Commission Splitting** in remuneration arrangements, and look forward to receiving more information on the Regulations that will implement them.

We also welcome the clarification that **Asset-based fees on ungeared portions of portfolios** will not constitute conflicted remuneration.

Finally, we inquire as to the progress of other aspects of the FOFA reforms in terms of the Wholesale/Retail client definition review, and the review of compensation arrangements.

Introduction

The Stockbrokers Association of Australia is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. Our membership includes stockbroking firms across the spectrum, ranging from the largest wholesale stockbroking firms to medium-sized firms, and down to the smallest firms, having mainly a retail client base.

The Stockbrokers Association is pleased to provide this submission to the Government on the *Corporations Amendment (Further Future of Financial Advice Measures) Bill*.

We note that one of the aims of FOFA (as expressed in Minister Shorten's announcement of 29 August) is to restore trust and improve the availability of advice to investors –

'It is a concern that only one in five Australians access financial advice. These reforms will restore trust and confidence in the sector following collapses such as Storm, Westpoint and Trio. They also remove the red tape that has prevented low-cost, good quality advice being delivered to millions of Australians.'

The activities of stockbrokers are far removed from those of Storm, Westpoint and Trio, which led to the wholesale review of financial services in Australia. Stockbrokers would like to think that there is already a relationship of trust with their clients. This is borne out by the fact that in 2010 complaints to the **Financial Ombudsman Service** about stockbrokers **fell by 75%**.

In this Submission, after some introductory comments on the advent of the prohibition model, we will concentrate on the following matters, which have already been the subject of detailed correspondence with Treasury during this year¹, namely the **carve-outs** from definition of **Conflicted Remuneration** of the following:

1. **Stockbrokers Carve-outs: Stamping Fees** on capital raisings and **Commission Splitting** in remuneration; and
2. **Asset-based fees on ungeared portfolios.**

Finally, we would like to inquire as to the progress of other aspects of the FOFA reforms.

Conflicted Remuneration: Prohibition v. Disclosure

The Bill contains a general prohibition on financial services licensees or advisers receiving '**conflicted remuneration**'. Conflicted remuneration is defined broadly as being any benefit that may influence the advice that is given. As stated in the *Explanatory Memorandum* to the Bill:

¹ For example, Submission to Treasury *Future of Financial Advice – Ban on Commissions – Impact on Stockbrokers* 8 August 2011 which can be found at <http://www.stockbrokers.org.au/PolicyRegulatoryIssues/RecentFOFASubmissions/tabid/363/Default.aspx>

1.12 Conflicted remuneration means any monetary or non-monetary benefit given to a licensee or representative that might influence or distort advice, by either influencing the choice of financial product being recommended or by otherwise influencing the financial product advice more generally. [Schedule 1, item 11, subsection 963(1)]

Placing an absolute **ban** on the **receipt** of conflicted remuneration is a different approach to the current law, which merely requires **disclosure** of any interests or benefits which may influence advice: section 947B(2)(d) and (e). This is complemented by other duties, for example the duty to act *honestly, efficiently and fairly*, and the proposed *best interests* duty in the earlier FOFA Bill. We are not convinced that the '*disclosure model*' needs to be replaced with prohibition. Once again we note that it appears that the law is being changed for the thousands of financial services licensees in Australia because of the misconduct of a few recalcitrant organizations in the lead up to the Global Financial Crisis. We are not convinced that in the stockbroking industry there is such a systemic problem in disclosure that it requires its replacement with prohibition.

Carve-outs from conflicted remuneration

There are various carve-outs in the Bill from *conflicted remuneration* for certain benefits in certain circumstances: section 963A. For example,

- benefits received for **execution-only** transactions (where no advice is given) are not considered conflicted remuneration: section 963A(1)(c).

As with the existing law, none of these provisions apply to dealings or advice given to **wholesale clients**.

Stockbrokers Carve-outs

The two carve-outs of most interest to our Members are those relating to **Stamping Fees** and **Commission Splitting**. **Stamping Fees** are fees earned by brokers in the sale of new securities to clients on behalf of the company in order to raise capital. **Commission Splitting** refers to the traditional and widespread stockbroker's remuneration model in which the adviser is paid a proportion of the brokerage paid by the client to the firm.² These carve-outs are not outlined in detail in the Bill. However, they will be set out in later Regulations to be made after the enactment of the Bill under the regulation-making power to exempt '*prescribed benefits...given in prescribed circumstances*': section 963A(1)(e) and section 963B(f).

The *Explanatory Memorandum* to the Bill refers to the carve-outs for Stamping Fees and Commission Splitting as follows:

² Further details of these arrangements are set out in our Submission of 8 August 2011 referred to in Note 1 above.

(Stamping Fees)

1.25 It is proposed to exclude certain stockbroking activities from being considered conflicted remuneration, by allowing persons undertaking these stockbroking activities to receive third party 'commission' payments from companies where those payments relate to capital raising. The precise breadth of the carve-out would be subject to further consultation, but it is proposed that the receipt of '**stamping fees**' from companies for raising capital on those companies' behalf not be considered 'conflicted remuneration' where the broker is advising on and/or selling certain capital-raising products to the extent that they are (or will be) traded on a financial market. It is proposed that the carve-out would apply to any person authorised to undertake the relevant stockbroking activities pursuant to the capital raising carve-out, including both direct and indirect market participants.

(Commission Splitting)

1.26 The regulations will also ensure that the **traditional remuneration arrangements** of employee brokers (often paid as a percentage of brokerage) are not unduly impacted by the conflicted remuneration measures. (*emphasis added*)

We welcome the Stockbrokers Carve-Outs, but are unable to provide detailed comments at this stage without further detail of the substance of the provisions, which we understand will not be available until consultation commences on the draft Regulations. Until that time, we look forward to continue assisting you in the consideration of the appropriate circumstances of the carve-outs, or any other matter which you may wish to discuss. For example, it is common in stockbroking for advisers to engaged on an exclusive contractual basis, rather than a normal employee arrangement. This is merely for tax or other purposes: in every other respect the adviser is an employee of the firm just like any other. We trust that the **Commission Splitting** carve-out will be flexible enough to encompass these alternative employment arrangements.

Asset-based fees on ungeared portfolios

Earlier in the FOFA process, it appeared that if **any portion** of a client's investments were funded by borrowings (i.e. 'geared'), asset-based fees could not be charged on the **entire portfolio**. Our members therefore welcome the provisions in the Bill which clarify that the ban only applies to the **ungeared portion** of the client's investments: section 964F. The *Explanatory Memorandum* states:

1.52 To the extent that a retail client's funds are not geared, the licensee and or their authorised representatives can charge an asset-based fee on that 'ungeared' component.

The exception in the Bill applies where it is not *reasonably apparent* that the investments are geared. Section 964F(2) states -

Subsection (1) [*i.e. the prohibition on charging asset-based fees on geared funds*] does not apply if it is not reasonably apparent that the funds used or to be used to acquire financial products by or on behalf of the client are geared funds.

We trust that the provisions of the Bill achieve the aim as expressed in the *Explanatory Memorandum* above, as the language is a little ambiguous. For example, it would assist if the prohibition more clearly applied only to the geared component, not the ungeared component.

Other FOFA matters and consultations

Finally, we look forward to further detail about other aspects of the wider FOFA project, in particular –

- the review of the **definitions of 'retail' and 'wholesale' investors**³, and
- the result of Mr St John's inquiry into **compensation arrangements**⁴.

We are once again grateful for the opportunity to raise these matters with the Government in the process of the enactment of these important matters of policy and law reform, and for the continuing dialogue with Treasury and ASIC officers.

We would of course be happy to discuss further any of the matters raised in this Submission.

David W Horsfield

Managing Director/CEO

STOCKBROKERS ASSOCIATION OF AUSTRALIA

³ FOFA Options Paper *Wholesale and Retail Clients* 26 January 2011

⁴ FOFA Consultation Paper *Review of compensation arrangements for consumers of financial services* April 2011