Stockbrokers Association of Australia
Incorporating SDIA

Future of Financial Advice (FOFA)
Corporations Amendment Regulation 2013 (No. N)

Submission: *Further Stockbroking Exemptions*
Exposure Draft 3 May 2013

16 May 2013

The Stockbrokers Association of Australia would like to make the following comments on the *Corporations Amendment Regulation 2013 (No. N)*. The amendments apply to stockbroking-related activities and the bans on conflicted remuneration and asset-based fees on borrowed amounts introduced by the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012*, exempting two activities from the bans:

- **brokerage** fees on **borrowed amounts**; and
- fees paid by licensees that execute trades on behalf of the retail clients of other licensees, where those trades are requested by the client through the non-executing licensee's **online trading service**, under circumstances where clients do not receive personal advice.

1. BROKERAGE ON BORROWED AMOUNTS (Reg.7.7A.17&18)

We **commend** the Government for exempting brokerage on borrowed amounts. As we pointed out in meetings and submissions in December 2012, to do otherwise would have created an unworkable situation where brokerage could not be charged on purchases of securities where margin lending, home equity or other forms of funding were used, but could on all other transactions. The Government has chosen the simplest solution. In not confining the

exemption to purchases financed by margin lending, the exemption will result in the most workable solution for stockbrokers, with no material impact on investor protection.

In terms of drafting we only make one suggestion: there should be clarification that the definition of ***brokerage fee*** in Reg.7.7A.17&18 is the same as that set out in Reg.7.7A.12D(2), namely:

> **7.7A.12D Brokerage fees given to representatives**
> (1) A monetary benefit is not conflicted remuneration if:
> (a) the benefit consists of a percentage, of no more than 100%, of a brokerage fee that is given to a provider who is a trading participant of a prescribed financial market; and
> (b) the provider, directly or indirectly, gives the benefit to a representative of the provider.
> *Note* The definition of ***prescribed financial market*** is in regulation 1.0.02A.
> (2) In this regulation:
> ***brokerage fee*** means a fee that a retail client pays to a provider in relation to a transaction in which the provider, on behalf of the retail client, deals in a financial product that is traded on:
> (a) a prescribed financial market; or
> (b) a prescribed foreign financial market.

This could be easily achieved by adding a Note to Regulation 7.7A.17&18 as follows:

> *Note* The definition of ***brokerage fee*** is in regulation 7.7A.12D(2).

2. WHITE LABEL STOCKBROKING FEES (Reg.7.7A.12D)

a) Typical Intermediary Arrangements v. White Label Arrangements

It is increasingly common for financial planners or other licensees that are not trading participants of an exchange (i.e. not stockbrokers) to advise clients on the purchase or sale of listed securities. While they are licensed to advise clients on listed securities, they cannot execute the transactions without a stockbroker. Accordingly, it is very common for the licensee to have a relationship with a stockbroker whereby the licensee refers orders for share sales or purchases to the stockbroker (by telephone, in writing or electronically), the stockbroker executes the trade on-market, the client settles directly with the stockbroker including brokerage, and the broker then remits a portion of the brokerage to the licensee. This arrangement is for convenience. Since the licensee is not a trading participant and is not connected to the ASX settlement system, the client must settle direct with the stockbroker so that the shares can registered directly into or out of the client's name. The stockbroker collects the fee as agent for the licensee, with the full knowledge and consent of the client.

When you compare the typical intermediary stockbroking arrangement described above to the arrangement described in the draft Regulation as a ***specified service***, it is clear that there are differences Under Subregulation 7.7A.12D(2), ***specified service*** is defined as follows:

> ***specified service*** means a broking service which:
> (a) is provided for retail clients by a financial services licensee that is not a trading participant; and
> (b) is provided under the name or brand name of that financial services licensee; and
> (c) relates to the dealing, on behalf of the client, in a financial product traded on:
> (i) a prescribed financial market; or
> (ii) a prescribed foreign financial market; and
> (d) is made available only by direct electronic access; and
> (e) is provided in circumstances in which the client does not receive personal advice in relation to the trades undertaken on the client's behalf by any licensee or authorised representative associated with those trades.

The 'typical' intermediary stockbroking arrangement differs from a ***specified service*** in two significant respects:

- it may not be completely 'white labelled' in the sense of being delivered under the name of the licensee in paragraph (b); and

- it may not just be available by direct electronic access in the sense of paragraph (d); the service may be available through other means such as telephone or email communication with the stockbroker in addition to being accessible purely via an electronic platform.

In the Draft Explanatory Statement to the Bill, the exemption is said to be consistent with what has come to be known as the **Scope of Influence Test.** This was first referred to in Example 1.1 of the Revised Explanatory Memorandum to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012*. It is used to refer to fee-sharing arrangements between parties where the provision of one service (here, the provision of research and analysis by the stockbroker to the licensee) could be said to have a **remote influence** on the resulting fee which is shared (namely, brokerage on the trading which is referred to the stockbroker by the licensee for execution).

The Scope of Influence Test is also used by ASIC in Regulatory Guide 246 *Conflicted Remuneration* with particular reference to white label arrangements. In a section headed '**White label stockbroking platforms and securities dealers'**, ASIC states:

> RG 246.98 If no exclusion applies, the securities dealer needs to rebut the presumption *[i.e. the presumption that volume-based benefits are conflicted remuneration under s963L]* and show that the benefit received is not conflicted remuneration—for example, see Example 1.1 in the Revised Explanatory Memorandum:
>
> > One licensee (the product provider) provides a white label equity trading platform to another licensee (the promoter), who labels the facility as their own and markets the facility to their clients. The promoter only provides general advice to clients in the form of independent market reports and analysis and has strong internal controls to prevent 'churning'. The client is charged a product neutral percentage-based fee on all transactions which is collected by the product provider. The product provider passes a proportion of that fee to the promoter. The proportion of the fee that is passed on to the promoter will be presumed to be conflicted under section 963L because the fee is volume-based. However, as the scope for influence in this case is remote, the product provider and promoter are likely to be able to establish that the payment is not conflicted remuneration.

With such clear statements of the regulator's attitude to white label arrangements already in place, we wonder **why the further exemption for white labelling is necessary at all**.

We are aware that this amendment was produced for the benefit of a major financial institution that does not itself operate a trading participant. While that is understood, it would be very disappointing if this amendment had the unintended effect of prejudicing existing and well established arrangements between trading participants and other licensees, the vast majority of which (as noted above) do not have the characteristics of *specified service* in the draft Regulation. Most of our Members will continue to collect and remit fees to licensees under the agency arrangements which were described to Treasury officials and not found wanting during the framing of FOFA several years ago. These arrangements will continue to operate with the full knowledge and consent of the client. We trust that these arrangements will not be affected by the implementation of the further exemption for white labelling, as this would be an **unintended consequence**, and a **bad regulatory outcome**.

b) Personal v. General Advice and the White Label Exemption

The Conflicted Remuneration provisions of FOFA apply to *financial product advice*: s963A. Under section 766B, financial product advice includes *personal* advice and *general* advice.

The Conflicted Remuneration provisions differ from the Best Interests obligations of FOFA, in that the latter only apply to *personal* advice: s961(1).

Accordingly, apart from a limited exemption relating to insurance, we believe that this is the only exemption from the ban on conflicted remuneration which implicitly excludes and allows

general advice. (It implicitly allows it because the exemption only requires that *personal* advice not be given.) This is a curious outcome.

c) Drafting Suggestions - the White Label Exemption

We would like to make two suggestions in relation to the drafting of the White Label Exemption:

- the use of the term ***non-trading participant*** in subregulation 7.7A.12D(1) when referring to the intermediary licensee is inappropriate because it may be confused with a category of participant on a stock exchange. These parties are not trading participants in any sense, and are not subject to the *Market Integrity Rules*. Therefore, in the subregulation, we submit that simply referring to them as ***licensees*** would be more appropriate and a better description of the arrangement;

- we understand that the exemption is unlikely to materially change. However, to assist in the proper interpretation of the exemption, it would assist if a note were added to the Regulation along the lines of a reference to **Example 1.1** of the Revised Explanatory Memorandum to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012* in the same way that ASIC has used the example in ASIC RG246.98 (noted above).

Thank-you for the opportunity to comment on the proposed regulations, and for your time and consideration during the period leading up to the announcement of the stockbrokers carve-outs and further exemptions. We would be happy to discuss this matter at your convenience. Should you require any further information, please contact me or Doug Clark, Policy Executive on dclark@stockbrokers.org.au .

David W Horsfield
Managing Director/CEO
Stockbrokers Association of Australia
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