Financial Industry Network Australia

FINA - Working together to make a difference

April 2014

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sirs,

Re: 'Grandfathering' provisions

FINA has been recently established as an association for financial industry professionals who feel that their place in the financial services industry is not adequately serviced by other industry associations. Our Members are not unique, but they provide compliance services, life insurance, securities and derivative trading and associated software facilities as well as financial planning advice and services to both retail clients and to other participants in the financial services industry.

In the main, the clients of our Members are retail clients, who are entitled to all the protections available under the law and the industry standards. However, our Members are not big business and they have built up their small businesses by developing good client relations and services.

The majority of our Members have over time purchased other small businesses or client lists to strengthen their long-term income. Under the present law, our Members are not able to pass on entitlements that they might have to continuing income under a sale of their business. Also, they are not able to buy a business, with retail clients and an existing continuing income stream.

In regard to the '**grandfathering**' provisions under the current and proposed law, including the Corporations Act (Cwth) 2001 and the Corporations Regulations, FINA is providing the attached submission on behalf of our Members.

Yours sincerely,

Ken Wybrow

Panel Member
Financial Industry Network Australia

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A. The historical position

1. Under the laws that existed prior to 2012, advisors were able to provide financial services to retail clients who were not able or willing to pay for the advice or the costs of implementing the recommended financial service. These retail clients received affordable appropriate advice knowing that their advisor would be remunerated by the product provider. It has been the law and good business practice for the advisor to fully disclose the remuneration and any other benefits that would arise from the service.
2. When there was a continuing income stream from the product provider, the advisor was often in a position to provide continuing reviews and other services to the client without imposing additional charges. If a client became dissatisfied with the advisor, the client could use another advisor, who would organise to have the income stream product transferred or would commence a replacement product or service. This situation provided an advisor with a loyal client base and, therefore, a business.
3. In the event that an advisor wished to reduce his or her client base (or exit the industry), the advisor had a business to sell. This market for financial services businesses was the reward to advisors for the work in establishing their businesses.
4. Since around 2009, the Financial Planning Association has advocated that its members should not receive any form of continuing income from product providers. They have been vocal in condemning 'commissions' and encouraging fee-for-service. The end result of this campaign could have left thousands of retail clients without access to affordable financial services.
5. However, those clients could still receive services from non-FPA advisors. Many FPA advisors were quick to sell parts of their business with income streams, retaining their best (wealthiest) clients. The market for these income streams provided the FPA advisors with cash and required the purchasing advisor to properly service the clients. If the clients were not properly serviced, the clients

could leave the purchasing advisor, who had then lost both the business and the purchase price.

6. The system had been developed under the Australian laws and the policy of free trade with adequate consumer protection. In brief, the financial service industry met client needs, provided a small-business opportunity for advisors and common sense prevailed.

B. The position since 2012

1. Certain segments of the community pressed forward with their objectives to ban what they had been convinced was a blanket incentive for advisors to provide bad advice. Since 1 July 2012, under Division 4 of Part 7.7A of the Corporations Act, there has been a ban on conflicted remuneration. It is not our intention to re-visit the merits, if any, of this ban. However, the Regulations to the Act provide exemptions to the ban.
2. In section 1528 (1) of the Act we read that Division 4 of Part 7.7A does not apply to a benefit given to a financial services licensee, or a representative of a financial services licensee, if:
   (a) the benefit is given under an arrangement that was entered into before the application day (i.e. 1 July 2013); and
   (b) the benefit is not given by a platform operator
3. There was also the addition of regulations 7.7A16A to regulation 7.7A.18 in a further attempt to clarify the position in relation to conflicted remuneration and all provisions applied as at 1 July 2013.

C. The 'grandfathering' position since 1 July 2013

1. Section 1528 (1) of the Act can be summarised as exempting the ban on conflicted remuneration in a situation where the benefit is given under an arrangement that was entered into before 1 July 2013.

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2. Regulation 7.7A16E (2) prescribes that a benefit is not conflicted remuneration where a party to the arrangement changes. This appears to allow any party to change, but has been interpreted in some instances as allowing the change of just one party at any time. For example:
    a. the licensee could change, where the advisor moves to a new licensee;
    b. the advisor could change without changing the licensee;
    c. the Responsible Entity of the product could change; or
    d. the client could change, as in transferring units from Joint names to one name, from an estate to a beneficiary or, potentially, by sale of the shares, units or title. This option gives eternal life to the non-conflicted remuneration, if the change is to successive beneficiaries or purchasers.
3. Regulation 7.7A16F prescribes that a benefit is not conflicted remuneration to the extent that the benefit is a pass through of a benefit that is consistent with the purposes of the arrangement under which the grandfathered benefit was paid and on conditions similar to those under section 1528 of the Act and regulations.

D. Sale and purchase of financial services business with exempt benefits

1. Regulation 7.7A12EA indicates that a benefit received by the vendor of a financial services business (where all or part of the price paid is calculated having regard to the value of all or part of the financial products held by the vendor's clients) is not conflicted remuneration.
2. The position in the financial services industry at present is not clear. Product providers have not recognised genuine sales of businesses and / or situations where there is a change to a party to an arrangement.
3. The situations where a financial services business changes parties are:
    a. The licensee has multiple advisors, the vendor advisor can sell to the licensee or to another representative of the licensee.

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b. The vendor advisor (sole proprietor) has placed the business into administration and the receiver/liquidator wishes to sell at a reasonable market price.
c. The vendor advisor (or licensee) has placed the corporate business into administration and the administrator/liquidator wishes to sell at a reasonable market price.
d. The vendor advisor (or licensee) wishes to sell to a representative of another licensee.

4. Point 3 (a) above appears to include both the purchaser and the vendor in the existing provisions. Particularly, subregulation 7.7A16E provides for the change to a party to the arrangement and the benefit continues to be exempt from the ban on conflicted remuneration.
5. Point 3 (b) above appears to cover the vendor under the existing provisions. Particularly, subregulation 7.7A16E provides for the change to a party to the arrangement (the change from the name of the advisor to the receiver) and the benefit continues to be exempt from the ban on conflicted remuneration. There is some doubt as to whether the change to the purchaser can be included in the provision which states "a change to **a** party to the arrangement". Product providers have informed our Members that, in their opinion, the benefit does not continue to be exempt from the ban on conflicted remuneration.
6. Point 3 (c) above appears to cover the purchaser and vendor under the existing provisions. Particularly, subregulation 7.7A16E provides for the change to a party to the arrangement (the change from the name of the corporate owner to the purchaser) and the benefit continues to be exempt from the ban on conflicted remuneration.
7. Point 3 (d) above appears to cover the vendor in the existing provisions. In the case of the purchaser, subregulation 7.7A16E provides for the "change to **a** party to the arrangement" and here there will be changes to the licensees and the advisors. Product providers have informed our Members that, in their opinion, the

benefit does not continue to be exempt from the ban on conflicted remuneration.

E. Possible solutions

1. It has been suggested in the case of a business in liquidation (point D5 above) that the purchaser should obtain the opinion of all relevant product providers before entering into any purchase contract. This is not satisfactory in practice and is by no means conclusive as product providers have differing opinions. Some product providers have suggested the receiver should ensure sale to the same licensee, but this is not always practical.
2. Our Members have also embarked on a staged purchase plan, where the vendor advisor is retiring and exiting the industry. The vendor transfers as a representative to the licensee of whom the purchaser is a representative. The clients are transferred to the new licensee with the vendor advisor under regulation 7.7A16E. Then, after a month or so, the clients are transferred from the vendor advisor to the purchasing advisor under regulation 7.7A16E.
3. An obviously preferable solution is for the re-drafting of subregulation 7.7A16E to ensure that from 1 July 2013:
    a. Change to the licensee and / or the advisor, as a result of a transfer of business by the advisor or licensee or a legal representative of the advisor or licensee would meet the conditions; and
    b. Change to the client would only meet the conditions in prescribed circumstances.