

APPENDIX C: ASIC CONSULTATION PAPER on FoFA

ASIC CONSULTATION PAPER 189 Future of Financial Advice: Conflicted remuneration

A. Background to the proposals

The provisions on conflicted remuneration and other banned remuneration in Divs 4 and 5 of Pt 7.7A of the *Corporations Act 2001* (Corporations Act) are a key part of the Government's Future of Financial Advice (FOFA) reform package. These obligations have been introduced to more closely align the interests of advisers and their retail Clients and improve the quality of financial product advice these Clients receive.

We propose to issue a new regulatory guide on our expectations for how AFS licensees and representatives can comply with the conflicted remuneration provisions. Our proposed guidance is set out in Sections B–H of this paper.

This section of the consultation paper sets out some background information on the FOFA reforms, the conflicted remuneration provisions and our approach in administering these provisions.

B. Conflicted remuneration

In deciding whether a benefit is conflicted remuneration, we propose to focus on the substance of a benefit over its form, and consider the overall circumstances in which the benefit is given: see paragraphs 39–44.

- 39 In deciding whether a benefit is conflicted remuneration, we will look at the substance of a benefit over its form, and consider the overall circumstances in which the benefit is given. The conflicted remuneration provisions are concerned with benefits that could influence the provision of financial product advice in a way that is not aligned with the interests of the Client. Whether this is the case will depend on the substance of a benefit, rather than its form, what the benefit is called or how it has been presented to the Client.
- 40 This means, for example, that doing the following does not change the fact that a benefit is conflicted remuneration:
- (a) stating in documentation that a benefit is not intended to influence the financial product advice; or
 - (b) renaming the conflicted remuneration as a form of remuneration that is not prohibited by the Corporations Act for example, renaming a commission from a product issuer an 'asset-based fee', even though the fee continues to be paid by the product issuer to the AFS licensee as a proportion of the Client's ongoing funds under management.
- 41 In forming a view on whether a benefit is conflicted remuneration, we will look at a range of factors, including:
- (a) how the AFS licensee or representative gains access to the benefit;
 - (b) who is giving the benefit;
 - (c) when the benefit is given;
 - (d) what reasonably appears to be the likely reason why the benefit is being given;
 - (e) how the value of the benefit is determined; and
 - (f) what the benefit is and its features.
- 42 We will generally consider a benefit that has a number of interrelated components as a single benefit if they are given at the same time.
- 43 A benefit does not need to relate to a specific financial product to be conflicted remuneration. For example, the benefit could be one that means the AFS licensee or representative is more likely to recommend financial products issued by a particular issuer.

- 44 A benefit may be conflicted remuneration if it influences an AFS licensee or representative to give financial product advice recommending that Clients acquire specific financial products, rather than providing them with factual information or non-product-specific advice, such as advice on budgeting or debt management

In addition to the conflicted remuneration provisions, there are other obligations in the Corporations Act that apply when financial product advice is provided to a retail Client. These operate alongside the conflicted remuneration provisions and apply even if a benefit is excluded from the conflicted remuneration provisions: see paragraphs 35–38.

C. Volume-based benefits

Volume-based benefits are presumed to be conflicted remuneration: s963L.

We propose that the size of a benefit, and the portion of the benefit that is volume based compared with the portion that is not, are relevant when looking to prove that a volume-based benefit is not conflicted remuneration: see paragraphs 54–55.

We propose that volume-based benefits that may be conflicted remuneration include:

- where a platform operator or other product issuer is also a licensed dealer group, benefits received in its capacity as platform operator or other product issuer (see paragraphs 56–58); and
- equity arrangements with representatives (see paragraph 59).

We propose that, in some circumstances:

- a volume-based benefit may not be conflicted remuneration if it is passed on to the Client (see paragraphs 60–62); and
- we are less likely to scrutinise a benefit that is not passed on to the adviser, if certain controls are in place (see paragraphs 63–64).

D. Performance benefits for employees

Not all performance benefits given to employees who provide financial product advice to retail Clients are conflicted remuneration.

In assessing whether they can show that a volume-based performance benefit is not conflicted remuneration, we propose that employers should consider:

- the eligibility criteria for the performance benefit;
- how difficult it is for staff to meet these criteria;
- the purpose of the performance benefit;
- the proportion of the benefit that is volume based;
- the link between the benefit and the financial product advice provided to Clients; and
- the proportion of the benefit to the overall remuneration of the employee: see Table 3.

We propose that, in administering the conflicted remuneration provisions, we are more likely to scrutinise performance benefits that are:

- (a) 5% or more of an employee's base salary, if the benefit is wholly volume based; or
- (b) 7% or more of an employee's base salary, if the benefit is partly volume based and regardless of what weighting is given to the volume-based criteria: see paragraphs 77–79.

E. Volume-based shelf-space fees

The Corporations Act prohibits a platform operator from accepting a benefit that is a volume-based shelf-space fee.

We propose that, when looking to show that a benefit is not a volume-based shelf-space fee:

- if the 'fee-for-service' exclusion is being relied on, there should be a correlation between the fee and the platform operator's costs in providing the service (see paragraphs 89–92); and

- if the 'scale efficiencies' exclusion is being relied on, we expect that platform operators will receive and keep a written, up-to-date and appropriately verified analysis from the funds manager about its costs and how the value of the rebate or discount is referable to the economies of scale the funds manager is able to realise by placing its products on the platform (see paragraphs 93–97).

We will not take action against a platform operator who accepts a volume-based shelf-space fee if that fee is passed on promptly to Clients: see paragraph 98.

F. Asset-based fees on borrowed amounts

In determining whether an amount is borrowed, we propose that AFS licensees and representatives cannot ignore any information they have discovered when making Client inquiries as a result of complying with the best interests duty in s961B: see paragraphs 110–111.

We propose that asset-based fees should only be charged on portfolios of products purchased with a combination of borrowed and non-borrowed amounts if it is possible to separately identify the financial products purchased with borrowed amounts from those purchased with non borrowed amounts: see paragraph 112.

G. Transitional provisions

The conflicted remuneration provisions apply to arrangements entered into on or after 1 July 2013 (unless an AFS licensee elects to comply with these provisions earlier).

We propose that a new arrangement is created when a Client is transferred into a new financial product: see paragraph 121.

H. Anti-avoidance

Where the conflicted remuneration provisions prohibit a person from giving or accepting a benefit, a scheme may be an avoidance scheme if it is structured so that an entity related to that person gives or accepts the benefit: see paragraph 128.

If a platform operator accepts a large flat fee that is not a volume-based shelf-space fee, this may be an avoidance scheme: see paragraphs 129–131.

In administering the anti-avoidance provision, we are less likely to scrutinise schemes that are normal commercial transactions conducted in the ordinary course of business: see paragraph 132.

I. Regulatory and financial impact

134 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:

- (a) ensuring that benefits that have the potential to influence financial product advice are not given, in light of the conflicted remuneration provisions in Divs 4 and 5 of Pt 7.7A of the Corporations Act;
- (b) ensuring that AFS licensees, their representatives and other entities comply with the conflicted remuneration provisions; and
- (c) not causing AFS licensees, their representatives and other entities to incur unreasonable costs in complying with the conflicted remuneration provisions.

135 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:

- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;

- (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR); and
- (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).

- 136 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 137 To ensure that we are in a position to properly complete any required RIS, please give us as much information as you can about our proposals or any alternative approaches, including:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits.

Appendix: Benefits that are not conflicted remuneration

Table 4: Benefits that are not conflicted remuneration

Type of benefit	Circumstances in which the benefit is given to an AFS licensee or its representatives that provide financial product advice to retail clients
Benefits for advice on general insurance products only: s963B(1)(a) and 963C(a)	<p>A monetary or non-monetary benefit, such as a commission, is not conflicted remuneration if it is given for advice on a general insurance product only.</p> <p>This exclusion will not apply if the benefit also relates to another financial product or to a product that is not a financial product (e.g. a credit facility).</p>
Benefits for advice on life risk insurance products only: s963B(1)(b)	<p>A monetary benefit is not conflicted remuneration if it is given for advice on a life risk insurance product only. A life risk insurance product is generally a life policy or a sinking fund policy that is a contract of insurance: see s761A(1)(e).</p> <p>There are some types of policy that this exclusion does not apply to. These are life risk insurance products that are:</p> <ul style="list-style-type: none"> • a group life policy for members of a superannuation entity; or • a life policy for a member of a default superannuation fund. <p>This means that the exclusion for life risk insurance products does not cover benefits for advice on:</p> <ul style="list-style-type: none"> • a group life risk policy inside superannuation whether it is for a default or another type of superannuation fund; and • an individual life insurance policy for the benefit of a member of a default fund.
Benefits in relation to execution-only services: s963B(1)(c)	<p>A monetary benefit is not conflicted remuneration if:</p> <ul style="list-style-type: none"> • it is given in relation to the issue or sale of a financial product; and • the financial product advice about the product, or products of that class, has not been given to the client by the AFS licensee or representative in the 12 months immediately before the benefit is given. <p>This means that a benefit is not conflicted remuneration if it is given in relation to an execution-only issue or sale of a financial product. However, this exclusion will only apply if the financial product advice about the product, or class of product to which the product belongs, has not been given to the client by the AFS licensee or representative in the 12 months immediately before the benefit is given.</p> <p>For AFS licensees that are part of a vertically integrated corporate group, if a separate AFS licensee within the group has provided financial product advice to the client within the previous 12 months, but the AFS licensee seeking to rely on the exclusion has not, this fact alone will generally not prevent the AFS licensee from relying on the exclusion.</p>
Benefits given by the client: s963B(1)(d) and 963C(e)	<p>A monetary or non-monetary benefit is not conflicted remuneration if it is given by a client in relation to:</p> <ul style="list-style-type: none"> • the issue or sale of a financial product by the AFS licensee or representative to the client; or <p style="margin-left: 40px;">Note: This does not apply to additional investments that do not result in an issue or sale, such as additional contributions to a superannuation account.</p> <ul style="list-style-type: none"> • financial product advice given by the AFS licensee or representative to the client: s963B(1)(d).

Type of benefit	Circumstances in which the benefit is given to an AFS licensee or its representatives that provide financial product advice to retail clients
	<p>For example, the fees a client pays for the financial advice are not regarded as conflicted remuneration.</p> <p>For this exclusion to apply, the benefit must be given to the AFS licensee or representative that provided the financial product advice to the client. For example, if financial product advice was provided by a representative, the benefit must be given by the client to the representative for the exclusion to apply.</p> <p>Benefits given by the client may include benefits that have been authorised by the client. This is because the Corporations Act states that a reference to doing an act, such as giving a benefit to an AFS licensee or representative, includes authorising the act to be done: s52.</p> <p>We will administer the law as if a benefit has been authorised by a client if it is given at their direction or with their clear consent. This is consistent with the Government's intention of how this exclusion is intended to operate: paragraph 2.2.7 of the Revised Explanatory Memorandum.</p>
Benefits for advice on interests in a time-sharing scheme: reg 7.7A.12	A benefit is not conflicted remuneration if it is given for financial product advice about an interest in a time-sharing scheme.
Benefits with a small value: s963C(b) and regs 7.7A.13 and 7.8.11A	<p>A non-monetary benefit is not conflicted remuneration if it is less than \$300 for each AFS licensee or representative that receives the benefit and identical or similar benefits are not given on a frequent or regular basis.</p> <p>We are more likely to consider a benefit is given on a frequent or regular basis if it is given at least three times over a one year period to the same AFS licensee or to the same representative.</p> <p>AFS licensees must keep records of benefits between \$100 and \$300 that are given to the licensee or one of their representatives: reg 7.8.11A.</p>
Benefits with an educational or training purpose: s963C(c) and regs 7.7A.14, 7.7A.15 and 7.8.11A	<p>A non-monetary benefit, regardless of who gives it, is not conflicted remuneration if it has a genuine educational or training purpose that is relevant to providing financial product advice to the client. The benefit must:</p> <ul style="list-style-type: none"> • be for the provision of an education or training course to an AFS licensee or representative (the participant); or • have the dominant purpose of education or training. <p>Where the benefit is for the provision of an education or training course:</p> <ul style="list-style-type: none"> • education and training activities for the course must take up at least the lesser of six hours a day or 75% of the time spent on the course; and • the participant or their employer or AFS licensee must pay for travel and accommodation relating to the course, and events and functions held in conjunction with the course. <p>Examples of benefits to which this exclusion applies include written material on the tax implications of a product and research on a class of products an adviser gives advice on that would further the adviser's knowledge about these products.</p> <p>AFS licensees must keep records of education and training benefits that they or their representatives receive: reg 7.8.11A.</p>

Type of benefit	Circumstances in which the benefit is given to an AFS licensee or its representatives that provide financial product advice to retail clients
<p>Benefits for information technology software and support: s9763C(d) and reg 7.8.11A.</p>	<p>A non-monetary benefit is not conflicted remuneration if it is for the provision of information technology software or support, and the benefit:</p> <ul style="list-style-type: none"> • is related to providing financial product advice to retail clients about the financial products issued or sold by the benefit provider; and • complies with the conditions in the regulations. At this stage, there are no conditions in the regulations. <p>We consider that the following types of benefit are likely to be covered by this exclusion:</p> <ul style="list-style-type: none"> • software for an administration platform where the benefit is given by the owner or distributor of the software; • access to an information technology 'help desk' for problems that an AFS licensee or representative experiences in using administration platform software, where the benefit is given by the owner or distributor of the software; and • access to a website to place client orders <p>We consider that the following types of information technology software and support are unlikely to be covered by the exclusion:</p> <ul style="list-style-type: none"> • payroll administration software and related support services; • accounting software and related support services to manage the accounts of an AFS licensee's or representative's business; and • anti-virus software. <p>If a licensed dealer group receives these kinds of benefits and uses them to meet operating costs, we are less likely to scrutinise the benefit under the conflicted remuneration provisions if:</p> <ul style="list-style-type: none"> • the benefit is not passed on to the adviser; and • there are controls in place to ensure that the benefit does not influence the financial product advice. <p>Our views on when this could be the case are discussed at paragraphs 63–64.</p> <p>AFS licensees must keep records of information technology software or support that they or their representatives receive: reg 7.8.11A.</p>
<p>Benefits given for advice about a basic banking product: s963D</p>	<p>A benefit is not conflicted remuneration if:</p> <ul style="list-style-type: none"> • it is remuneration for work carried out, or to be carried out, by the AFS licensee or representative as an agent or employee of an Australian ADI, or by otherwise acting by arrangement with an Australian ADI under the name of the Australian ADI; • access to the benefit, or the amount of the benefit, is dependent on the AFS licensee or representative recommending a basic banking product only; and • the AFS licensee or representative does not, in the course of recommending that basic banking product, give other financial product advice that does not relate to a basic banking product: s963D. <p>This exclusion is designed to allow agents and employees of an Australian ADI, and other representatives acting under the name of the Australian ADI, to receive sales bonuses and other forms of conflicted remuneration.</p>

Type of benefit	Circumstances in which the benefit is given to an AFS licensee or its representatives that provide financial product advice to retail clients
	<p>The exclusion may apply to a number of arrangements where a person is working for an Australian ADI under the name of the Australian ADI, including:</p> <ul style="list-style-type: none"> • contractors; • employees of employment agencies who may be working temporarily for the Australian ADI; • employees of a body corporate related to the Australian ADI; and • employees of another company who work exclusively for the Australian ADI. <p>Note: This is not intended to be an exhaustive list.</p> <p>However, the exclusion does not apply if financial product advice is provided on any product that is not a basic banking product.</p>