



ASIC

Australian Securities & Investments Commission

REPORT 328

Response to submissions on CP 189 Future of Financial Advice: Conflicted remuneration

March 2013

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 189 *Future of Financial Advice: Conflicted remuneration* (CP 189) and details our responses in relation to these issues.

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In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

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- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
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- describing the principles underlying ASIC's approach
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This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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A Overview

- 1 In April 2010, the former Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen MP, announced the Australian Government's Future of Financial Advice (FOFA) reform package.
- 2 The Revised Explanatory Memorandum to the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 (Revised Explanatory Memorandum) states:

The underlying objective of the reforms is to improve the quality of financial advice while building trust and confidence in the financial advice industry through enhanced standards which align the interests of the adviser with the client and reduce conflicts of interest.
- 3 On 25 June 2012, the Parliament passed the *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* to give effect to the objectives of the FOFA reforms, including introducing provisions on conflicted remuneration and other banned remuneration—referred to in this report as the 'conflicted remuneration provisions'. These provisions are set out in Divs 4 and 5 of Pt 7.7.A of the *Corporations Act 2001* (Corporations Act).
- 4 To help Australian financial services (AFS) licensees and their representatives comply with the conflicted remuneration provisions, we consulted on proposed guidance in Consultation Paper 189 *Future of Financial Advice: Conflicted remuneration* (CP 189).
- 5 This report highlights the key issues that arose out of the submissions received on CP 189, and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 189. We have limited this report to the key issues.
- 7 For a list of the non-confidential respondents to CP 189, see the appendix. Copies of these submissions are available on the ASIC website at www.asic.gov.au/cp under CP 189.

Consultation process

- 8 In CP 189, we consulted on proposals to help AFS licensees and other persons comply with the conflicted remuneration provisions in Divs 4 and 5 of Pt 7.7A.

- 9 Our proposed guidance in CP 189 sets out how we will administer the new rules, which ban:
- (a) AFS licensees and their representatives (including authorised representatives) from accepting conflicted remuneration (s963E, 963G and 963H);
 - (b) product issuers and sellers from giving conflicted remuneration to AFS licensees and their representatives (s963K);
 - (c) employers from giving their AFS licensee or representative employees conflicted remuneration for work they carry out as an employee (s963J);
 - (d) a platform operator accepting a volume-based shelf-space fee from a funds manager s964A(1); and
 - (e) an AFS licensee, or its representative, who provides financial product advice to a retail client charging asset-based fees on borrowed amounts used to acquire financial products for the client (s964D and 964F).
- 10 We have released our final guidance on conflicted remuneration: see Regulatory Guide 246 *Conflicted remuneration* (RG 246).
- 11 We will assess whether there is a need for further guidance after observing how industry complies with the conflicted remuneration provisions, in light of our regulatory experience and any case law on these obligations.

Responses to consultation

- 12 We received 36 responses (including 10 confidential responses) on CP 189 from industry associations, banks, trustees of superannuation funds, financial advisory and stockbroking firms, and legal practitioners. We are grateful to the respondents for taking the time to send us their comments.
- 13 We also held roundtable discussions with the following groups and their members:
- (a) Abacus Australian Mutuals;
 - (b) Association of Financial Advisers;
 - (c) Association of Superannuation Funds Australia;
 - (d) Australian Bankers' Association;
 - (e) Australian Financial Markets Association;
 - (f) Australian Institute of Superannuation Trustees;
 - (g) consumer representatives;
 - (h) Corporate Super Association;
 - (i) external dispute resolution (EDR) schemes;

- (j) Financial Planning Association;
- (k) Financial Services Council;
- (l) Industry Super Network;
- (m) Stockbroking Association of Australia; and
- (n) the Joint Accounting Bodies.

- 14 Additionally, we met with a range of industry participants—including industry associations and individual firms—to discuss our proposed guidance.
- 15 EDR schemes, consumer representatives, the not-for-profit superannuation sector and the accounting bodies were supportive of our proposed approach.
- 16 Other respondents welcomed the provision of guidance by ASIC but expressed concerns about specific aspects of our proposals.
- 17 Sections B–H of this report set out in more detail the issues raised during our consultation, and our responses to those issues.

B Conflicted remuneration

Key points

This section outlines the key issues raised in submissions on Section B of CP 189 and our responses to those issues.

It covers our proposed guidance on:

- assessing the substance of a benefit to determine whether it is conflicted remuneration;
- passing on excluded benefits; and
- benefits of a small value.

The substance of the benefit

- 18 In CP 189, we proposed guidance that, 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.
- 19 We stated that 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.
- 20 Our proposal to look at substance over form was supported by most respondents, although a number of respondents suggested changes to the application of our proposals. The key issues raised by respondents on the scope of the ban on conflicted remuneration are set out below.
- 21 In addition to specific comments on our proposed guidance, many respondents also asked us to provide examples of remuneration that is not conflicted.

ASIC’s response

As requested, we have provided further examples of remuneration that is not conflicted, including in relation to fees agreed through application forms: see Example 2 in RG 246.

After reviewing the examples in CP 189, we deleted some that we consider have more limited practical relevance (e.g. Example 16 in CP 189 describing one scenario when existing trailing commissions will not constitute conflicted remuneration). We have also modified other examples based on the feedback we received. We will consider adding further examples as our regulatory experience develops.

Product-neutral benefits

- 22 In paragraph 43 of CP 189, we stated that a benefit does not need to relate to a specific financial product to be conflicted remuneration—for example, a benefit could be conflicted remuneration if it results in an AFS licensee or representative being more likely to recommend financial products issued by a particular issuer.
- 23 Additionally, in paragraph 44 of CP 189, we stated that 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 advice that is not product-specific, such as advice on budgeting or debt management. Some respondents thought that this paragraph should be amended to clarify that only a benefit that influences an AFS licensee or representative to give *inappropriate* financial product advice is conflicted remuneration.
- 24 More generally, some submissions to CP 189 suggested that product-neutral benefits are unlikely to be conflicted remuneration or that being product-neutral is a factor that helps indicate a benefit is not conflicted remuneration. They argued that these benefits are unlikely to influence the choice of financial products that are recommended to a retail client.
- 25 On the other hand, one submission argued that product-neutral benefits are caught by the conflicted remuneration provisions.

ASIC's response

We disagree with submissions that suggested that product-neutral benefits are unlikely to be conflicted remuneration. We consider that the guidance we have provided on this issue is consistent with the law.

We remain of the view that a benefit may be conflicted remuneration if it could reasonably be expected to influence an AFS licensee or representative to give product-specific financial product advice, rather than giving strategic advice, such as retirement planning advice or advice on wealth accumulation strategies.

In RG 246.54, we explain that we have taken this view because the concept of conflicted remuneration includes any benefit that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the financial product advice given to clients by an AFS licensee or representative: s963A(b).

Additionally, it is important to note that the ban on conflicted remuneration is related to but distinct from other obligations in Pt 7.7A, such as the requirement to only provide advice if, in light of the actions the advice provider should have taken to comply with the best interests duty, it is appropriate for a client: s961G. Satisfying one obligation in Pt 7.7A does not remove the requirement to comply with the other obligations in Pt 7.7A. Therefore, the ban on conflicted remuneration may apply even if the advice in question satisfies s961G in being appropriate for a client.

Passing on excluded benefits

- 26 Some respondents submitted that, if a benefit is exempt from the conflicted remuneration provisions, it will continue to be exempt if it is passed on to others or is reflected in another benefit. They asked us to state this in our guidance.
- 27 For example, some respondents suggested that because asset-based fees paid by a retail client are excluded from being conflicted remuneration, a performance benefit for a representative that is based on the asset-based fees paid by their clients is not conflicted remuneration.

ASIC's response

We do not agree with the suggestion that, if a benefit is exempt from the conflicted remuneration provisions, it will continue to be exempt if it is passed on to others or is reflected in another benefit, because this is inconsistent with the law.

In our view, when an exempt benefit is passed on or reflected in a benefit given to another person, it does not automatically continue to be exempt from the conflicted remuneration provisions. This is because the benefit that is passed on is a separate benefit to the exempt benefit, and must be considered on its own merits. The benefit that is passed on is only exempt if it:

- satisfies the conditions of an exclusion (see the appendix to RG 246 for a list of significant exclusions); or
- could not reasonably be expected to influence the advice.

We have included guidance on this issue in RG 246.41–RG 246.45.

Benefits of a small value

- 28 In CP 189, we proposed guidance that a benefit is more likely to be conflicted remuneration if:
- (a) its value is greater than \$300 for each AFS licensee or representative that receives the benefit; or
 - (b) for benefits that are given on a frequent or regular basis, the combined value of all benefits given is greater than \$300 for each AFS licensee or representative that receives the benefit.
- 29 We stated that we would be more likely to consider that a benefit was given on a regular or frequent basis if it was given at least three times over a one-year period.
- 30 About half of the submissions we received supported our proposed guidance.
- 31 Among respondents who disagreed with the guidance, several commented that the dollar amount and frequency threshold seemed overly restrictive.
- 32 One respondent stated that it should be left to the AFS licensee to determine what is appropriate. However, another said that it was easier for industry to operate on the basis of a clear cap, rather than looking at individual benefits to determine if they are conflicted remuneration.
- 33 Commenting on individual elements of the proposal, more than half of the respondents supported the \$300 figure proposed as a guide in considering when monetary benefits are likely to be conflicted remuneration. Two respondents highlighted the need for the dollar figure to be indexed to remain relevant.
- 34 A few respondents submitted that four times a year should not be considered reasonably likely to influence advice. One respondent suggested that five or more times per calendar year would be appropriate.

ASIC's response

We have revised our guidance to highlight when we are more likely to scrutinise a small-value benefit to determine whether it is conflicted remuneration, as opposed to setting thresholds for when such a benefit is more likely to be conflicted remuneration.

In our final guidance, we have also better reflected the legal requirements attaching to benefits of varying small values—that is:

- a non-monetary benefit is not conflicted remuneration if it is less than \$300 for each AFS licensee or representative that is the final recipient of the benefit, and identical or similar benefits are not given on a frequent or regular basis (s963C(b) and reg 7.7A.13); and
- an AFS licensee must keep records of benefits between \$100 and \$300 that are given to it or any of its representatives (reg 7.8.11A).

Therefore, our guidance states that we are more likely to scrutinise monetary and non-monetary benefits to determine whether they are conflicted remuneration if:

- for benefits that are given on a frequent or regular basis:
 - the value of each benefit is over \$100; and
 - the combined value of all benefits is greater than \$300 for each AFS licensee or representative that is the final recipient of the benefit; or
- for a benefit that is not given on a frequent or regular basis, its value is greater than \$300 for each AFS licensee or representative that is the final recipient of the benefit: see RG 246.78.

C Volume-based benefits

Key points

This section outlines the key issues raised in submissions on Section C of CP 189 and our responses to those issues.

It covers our proposed guidance on:

- rebutting the presumption that volume-based benefits are conflicted remuneration;
- equity arrangements with representatives;
- white label arrangements; and
- management fees.

Rebutting the presumption

- 35 In CP 189, we proposed that the presumption in s963L that volume-based benefits are conflicted remuneration can be rebutted by showing that the value of the benefit is not significant enough that it could reasonably be expected to influence the financial product advice given to a client.
- 36 We stated that the value of the benefit will need to be assessed objectively, based on the circumstances as a whole, including the size of the benefit, and the proportion of the volume-based benefits compared with the proportion of non-volume based benefits.
- 37 The majority of respondents agreed with our guidance on rebutting the presumption in s963L.
- 38 Some respondents suggested that the presumption could also be rebutted if a benefit had a remote influence on the advice. One example might be a benefit given to someone who has not provided financial product advice to a retail client in the past year.

ASIC's response

We have provided further guidance on the types of considerations that may be relevant in assessing whether the presumption that volume-based benefits are conflicted remuneration can be rebutted: see RG 246.91.

Our guidance states that relevant considerations include the connection between the benefit and the financial product advice and how often the AFS licensee or representative who receives the benefit provides financial product advice to retail clients.

Equity arrangements with representatives

- 39 In CP 189, we proposed that equity arrangements with representatives may be conflicted remuneration.
- 40 Many respondents commented that equity arrangements are a common feature of the financial advice industry and expressed concern that these arrangements may be assumed to be conflicted remuneration. They thought that the majority of equity arrangements would not be conflicted remuneration.
- 41 Respondents submitted that equity arrangements play an important role in rewarding top performers and providing for succession planning.
- 42 A few respondents acknowledged that some equity arrangements may result in conflicted remuneration being paid (e.g. where it is based on the amount of client funds in a particular issuer's products). However, they submitted that in other situations an equity arrangement will not involve the payment of conflicted remuneration (e.g. where it is based on the value of an advice business).
- 43 Additional guidance was requested on the circumstances in which equity arrangements may or may not be considered to be conflicted remuneration.

ASIC's response

In response to this feedback, we have included additional detail in RG 246 to help industry determine when an equity arrangement may be conflicted remuneration: see RG 246.106–RG 246.111.

In our final guidance, we have also acknowledged that an equity arrangement may have a role in ensuring the interests of a representative are more closely aligned with the ongoing success of an AFS licensee's business. We have reiterated that an equity arrangement is only conflicted remuneration if it could reasonably be expected to influence the advice that the representative gives.

White label arrangements

- 44 Example 6 in CP 189 described a white label arrangement under which the client pays the platform operator a bundled fee for administration and distribution services, which is split between the platform operator and dealer group. We stated that any volume based margin accessed by the dealer group would be treated as conflicted remuneration to the extent that the fee is dependent on volume, unless otherwise shown.

Note: A white label arrangement is an arrangement where a licensed dealer group enters into contractual arrangements with a platform operator to rebrand the platform operator's platform to make it appear as its own—that is, the platform is 'badged' or 'promoted' by the dealer group as its own product.

- 45 Several respondents expressed concern about the effect of the proposed guidance on the provision of white label arrangements. Of these respondents, some were concerned that if bundled fee arrangements are prohibited, it may become impractical or uneconomical to provide these services, resulting in reduced competition in the platform market.
- 46 A number of respondents suggested that Example 6 should be changed to be more consistent with the Example 1.1 in the Revised Explanatory Memorandum, which outlines a situation where the presumption that a volume-based fee is conflicted remuneration can be rebutted, as the scope for influence on advice is remote.
- 47 They also requested that we include more guidance on how the conflicted remuneration provisions apply to white label broking platforms.

ASIC's response

Based on the feedback we received, we have included new guidance in RG 246 outlining how the conflicted remuneration provisions apply to white label stockbroking platforms and securities dealers: see RG 246.93–RG 246.98.

As requested by some respondents, we have referred to the fact that a securities dealer who provides advice and also receives brokerage from a market participant operating a platform may be able to rebut the presumption that this volume-based benefit is conflicted remuneration. Our guidance refers to Example 1.1 in the Revised Explanatory Memorandum, which describes one way in which this may be done.

Management fees

- 48 In CP 189, we noted that the conflicted remuneration provisions may prevent some product issuers from giving financial product advice to retail clients to increase or maintain their investment or other interest in the issuer's products. This is because this advice may result in an increase in, or the maintenance of, management or other fees payable out of the fund. These fees might reasonably be expected to influence the advice.
- 49 Most respondents thought that this would be a concern or an unintended consequence. Some of the impacts they submitted it could have include:
- (a) product issuers may not be able to give general advice promoting their own products;
 - (b) trustees of super funds may be prevented from giving intra-fund advice;
 - (c) educational materials for investors created by product issuers may not be able to be given as they usually contain general advice; and
 - (d) information about the investment menu of a product may not be able to be given if this contains general advice.

50 For respondents who were concerned about this issue, most thought that ASIC or the Australian Government should grant an exemption for management fees. Alternatively, they suggested that ASIC should provide additional guidance clarifying that management fees received by issuers when providing general advice about their own products are permitted.

ASIC's response

We consider that it is an unintended consequence for the conflicted remuneration provisions to apply to a product issuer that accepts management and administration fees where:

- the product issuer does not provide any personal advice about products that it issues or products of that class, except for 'intra-fund advice'; and/or
- the product issuer is a trustee of a registrable superannuation fund and provides 'intra-fund advice'.

Therefore, we have decided to take a conditional no-action position, so that we will not take regulatory action in relation to:

- a product issuer that breaches the conflicted remuneration provisions by accepting management or administration fees; or
- a responsible entity of a registered managed investment scheme that breaches its duty to ensure that all payments out of scheme property, such as management fees, are made in accordance with the Corporations Act, where it accepts a payment that is caught by the ban on conflicted remuneration.

We have also taken a no-action position where a trustee of a registrable superannuation fund breaches the conflicted remuneration provisions by accepting management or administration fees when providing 'intra-fund' advice.

See RG 246.112–RG 246.116.

While an ASIC no-action position states our current intention not to take regulatory action on a particular state of affairs or conduct, it does not preclude third parties from taking legal action on conduct covered by the no-action position: see Regulatory Guide 108 *No-action letters* (RG 108).

D Performance benefits for employees

Key points

This section outlines the key issues raised in submissions on Section D of CP 189 and our responses to those issues.

It covers our proposed guidance on:

- how the conflicted remuneration provisions apply to performance benefits;
- evaluating the performance benefit; and
- when a performance benefit may be conflicted remuneration.

Performance benefits and conflicted remuneration

- 51 In CP 189, we proposed guidance that performance benefits for employees may include:
- (a) bonuses;
 - (b) pay rises;
 - (c) attendance at networking events;
 - (d) promotion or other forms of recognition;
 - (e) reward-focused conferences and other events; and
 - (f) shares or options in their employer.
- 52 We stated that these benefits will be conflicted remuneration if they influence the financial product advice given by an employee that is an AFS licensee or representative.
- 53 Our guidance on this issue elicited a high volume of responses, including significant disagreement.
- 54 Many respondents objected to what they viewed as ASIC's interference with their ability to 'incentivise' employees. They thought that the proposed guidance would make it difficult for licensees to offer their representatives any form of performance-based pay. This was seen as being at odds with the commercial nature of the industry.
- 55 Some respondents disagreed that promotion, networking events and conferences were potential sources of conflicted remuneration.

- 56 In Example 11 of CP 189, we considered remuneration for a financial planner who services the existing client base of their employer who is an AFS licensee. Each year the planner's salary is adjusted to reflect any increase in the asset-based fees paid by the clients of the AFS licensee they advise. We stated that, to the extent that the planner's salary progression is based on the increase in asset-based fees paid by the planner's clients, this is a volume-based benefit and is presumed to be conflicted remuneration.
- 57 We received many comments about Example 11. Several respondents suggested that it appeared to confuse volume-based financial product incentives, which are presumed to be conflicted remuneration, with asset-based fees paid by the client, which are not. Others said that this example would have limited relevance for most businesses, as it is based on a planner who only services existing clients and does not have a role in developing new business.

ASIC's response

We recognise that there is a need to strike a balance between rewarding performance and avoiding inappropriate influence over financial product advice, and that AFS licensees will want to ensure that the remuneration they offer allows them to attract and retain high-performing employees. Nevertheless, as explained in our final guidance, complying with the conflicted remuneration provisions may mean that remuneration arrangements currently used in many financial services businesses will need to change.

Wherever possible, we have provided additional guidance in RG 246 to help AFS licensees understand how the conflicted remuneration provisions apply to performance benefits for employees.

In light of the feedback we received, we have provided two examples relating to employee remuneration in Section D of RG 246.

Example 10 describes a situation where, in our view, a bonus paid to a financial adviser does not represent conflicted remuneration.

Example 11 in RG 246 is based on Example 11 in CP 189. We have clarified that, if an adviser's salary progression is based on the increase in asset-based fees paid by their clients, this is a separate benefit to the asset-based fees, and must be considered separately. Because the way the salary progression is structured represents a volume-based benefit, this salary progression is presumed to be conflicted remuneration. It is up to the employer to rebut this presumption. We have also provided guidance on how this presumption could be rebutted in those circumstances.

Evaluating the performance benefit

- 58 Where a ‘balanced scorecard’ approach is used, and this includes volume-based criteria, in CP 189 we stated that the performance arrangement is presumed to be conflicted remuneration.
- 59 In paragraph 72 of CP 189, we listed some types of non-volume-based criteria on which a balance scorecard may be based. We stated that some of these criteria will be prerequisites for eligibility to receive a performance benefit, rather than a factor on which the value of the performance benefit is based. For this reason, employers need to evaluate the performance benefit as a whole to determine whether it is not conflicted remuneration.
- 60 In Table 3, we set out issues to consider when evaluating performance benefits.
- 61 Slightly more than half of respondents supported (either fully or with qualification) our general approach to evaluating performance benefits.
- 62 Additional non-volume-based criteria proposed by respondents were:
- (a) the success of financial advice strategies recommended by the employee; and
 - (b) revenue generated to the employer, derived from client fees.
- 63 A few respondents asked for further guidance on the principles that are relevant to whether a benefit could reasonably be expected to influence advice. Alternatively, they suggested that Table 3 should be changed to be more consistent with paragraph 2.20 of the Revised Explanatory Memorandum, which sets out various principles to consider when evaluating performance benefits.

ASIC’s response

As requested by respondents, we have included further guidance on the factors that are relevant to consider when evaluating a performance benefit, drawing on the principles set out in paragraph 2.20 of the Revised Explanatory Memorandum. These factors include considering how directly the recipient of the benefit is involved in the advice-giving process, and the weighting of the benefit in the total remuneration: see Table 3 of RG 246.

When a performance benefit may be conflicted remuneration

- 64 In CP 189, we proposed 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.

65 We received a range of views on this aspect of our proposed guidance. Many respondents expressed difficulties with ASIC providing indicative thresholds for when we are more likely to scrutinise a benefit. There was a view that this approach would not suit the range of roles and responsibilities in the industry.

66 EDR schemes, consumer representatives and superannuation bodies were among those who supported the proposed guidance. Their support was based on the need for certainty and a way of preventing the reforms being circumvented.

67 Some respondents proposed alternate percentage thresholds, ranging from 1% of salary (for wholly volume-based benefits) to 15–20 % of salary.

ASIC's response

There was particular interest in our proposed guidance on performance benefits for employees. We recognised that industry required early certainty on our position on this issue in order to arrange their employee remuneration arrangements for the 2013–14 financial year. For this reason, we announced our position on this issue on 13 December 2012: see ASIC Media Release 12-317MR *ASIC releases key FOFA guidance*.

As noted in our media release, we have decided to remove indicative thresholds from our final guidance, and instead focus on the principles underlying when a performance benefit is more likely to be conflicted remuneration, including the factors set out in Table 3 of RG 246.

We think that this will provide a more flexible approach, while still reiterating the strong focus of the FOFA reforms on enhancing the quality of advice by removing conflicted remuneration.

E Volume-based shelf space fees

Key points

This section outlines the key issues raised in submissions on Section E of CP 189 and our responses to those issues.

It covers our proposed guidance on the scale efficiencies exclusion.

The scale efficiencies exclusion

- 68 In CP 189, we proposed guidance on what platform operators need to demonstrate if they are relying on the scale efficiencies exclusion to show that a fee is not a prohibited volume-based shelf-space fee.
- 69 In paragraph 94 of CP 189, we stated that we expect platform operators to be able to demonstrate how a rebate or discount was arrived at and how it is referable to efficiencies gained by the funds manager from distributing its products through the platform. We stated that in doing this, 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 scale efficiencies.
- 70 In paragraph 95 of CP 189, we stated that we also expect the analysis to set out details about how the funds manager's fixed costs have reduced by reference to the number or value of financial products that are acquired by clients using the platform.
- 71 Many respondents did not support this proposal. They expressed concern that it may impose a significant compliance burden on platform operators, and that our proposed approach was more prescriptive than that envisaged by the legislation.
- 72 Several respondents suggested that platform operators may experience practical difficulties complying with our proposal. For example, funds managers may be asked to share commercially sensitive information with platform operators, and may be unwilling to do so.
- 73 However, one respondent argued that the scale efficiencies exclusion could result in the renaming of volume-based shelf-space fees and should not be permitted.

ASIC's response

While we acknowledge concerns about our proposed guidance on this issue, it is important to note that the scale efficiencies exclusion can only be relied on by a platform operator to the extent it can be shown that a fee does not exceed the fund manager's economies of scale from using the platform, as required by s963A(3)(b). Our guidance simply sets out our interpretation of how this could be demonstrated.

Nevertheless, based on the feedback we received, we have made our guidance more flexible. While we have retained the guidance proposed in CP 189, we have clarified that this is only one way of relying on the scale efficiencies exclusion. We have stated that other methods may be used if they provide, at a minimum, the same level of analysis and veracity in measuring the scale efficiency: see RG 246.156–RG 246.161.

F Asset-based fees on borrowed amounts

Key points

This section outlines the key issues raised in submissions on Section F of CP 189 and our responses to those issues.

It covers our proposed guidance on:

- portfolios of products purchased with borrowed and non-borrowed amounts; and
- instalment warrants.

Portfolios of products

- 74 In CP 189, we proposed 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.
- 75 Just over half of the respondents on this issue disagreed with our proposed guidance. Their principal concern was the difficulty for advisers in identifying the level of gearing involved in an investment portfolio, including how to monitor this on an ongoing basis.
- 76 Some respondents also submitted that, where it is possible to distinguish between the borrowed and non-borrowed portion, it should not be necessary to separately identify whether individual investment products are geared.
- 77 Some respondents proposed an alternate approach for dealing with portfolios of products purchased with borrowed and non-borrowed amounts. They suggested focusing on the amount the client has borrowed, rather than which products are purchased with borrowed amounts. Their suggested approach was to identify the value of the portfolio as a whole and deduct the borrowed amount to determine the non-borrowed portion against which asset-based fees were not prohibited.

ASIC's response

There is a clear legislative prohibition on the charging of asset-based fees on borrowed amounts: see s964B–964H. However, we have modified our final guidance to provide a more practical approach to complying with this prohibition for portfolios of products.

In RG 246.177, we state that, if a client has a portfolio of products purchased with a combination of borrowed and non-borrowed amounts, the net value of the portfolio should be determined, and the amount borrowed (less any amount repaid) should then be deducted from this net value. Asset-based fees should only be charged on the resulting value of the portfolio after borrowed amounts are deducted.

Instalment warrants

- 78 Two respondents submitted that the ban on asset-based fees on borrowed amounts does not apply to instalment warrants. They argued that, while instalment warrants generally include both a debt and an equity component, they do not share the characteristics of other leveraged investments such as margin lending facilities. These respondents asked for confirmation in our guidance that the ban on asset-based fees on borrowed amounts does not apply to instalment warrants.

ASIC's response

Our view is that the ban on asset-based fees on borrowed amounts applies to the extent that an asset-based fee is referable to the debt component of an instalment warrant. Where this is the case, we consider any asset-based fees charged are charged on a borrowed amount used or to be used to acquire the instalment warrant by or on behalf of the client: s964D and 964E.

In response to respondents' requests, we have provided specific guidance on this issue: see RG 246.173–RG 246.176.

G Transitional provisions

Key points

This section outlines the key issues raised in submissions on Section G of CP 189 and our responses to those issues.

It covers our proposed guidance on when the transitional provisions apply, including situations where:

- there is a transfer of an advice business;
- there is a transfer to a new financial product; and
- the ban on asset-based fees on borrowed amounts does not apply.

When do the transitional provisions apply?

79 To assist AFS licensees and their representatives in determining when the conflicted remuneration provisions apply, we proposed to give guidance on what arrangements the transitional provisions may apply to and in what circumstances.

80 Under the transitional provisions, the conflicted remuneration provisions do not apply to a benefit given to an AFS licensee or representative if the benefit is given under an arrangement entered into before the application day: s1528(1) and reg 7.7A.16. These benefits are ‘grandfathered’.

Note: The ‘application day’ is the date on which the conflicted remuneration provisions apply to an individual or entity (i.e. 1 July 2013, or earlier if an AFS licensee elects to comply with the conflicted remuneration provisions before that date).

81 We received numerous requests for additional guidance explaining when an arrangement may be grandfathered. In particular, many respondents were unclear about what constitutes a ‘new arrangement’ or ‘new financial product’ in the context of an existing client.

82 Respondents also asked specific questions about how the transitional provisions apply to individual products or sectors in the financial advice industry.

Transfer of an advice business

83 In paragraph 118 of CP 189, we proposed that a benefit under an arrangement entered into before the application day may be transferred to another AFS licensee or representative on or after the application day without attracting the conflicted remuneration provisions, depending on the form of the arrangement and how the transfer is made.

- 84 Although none of the respondents objected to the substance of this proposal, several respondents requested clarification of what is meant by ‘depending on the form of the arrangement and how the transfer is made’, as well as an example of how the guidance applies to the transfer of an advice business.

ASIC’s response

At the date of issue of this report, the Australian Government is consulting on regulations to clarify how the grandfathering provisions apply if a party to an arrangement changes. We will update our guidance to take into account the effect of the regulations after they have been finalised.

Transfer to a new financial product

- 85 In paragraph 121 of CP 189, we proposed that, for arrangements that existed before the application day (‘old arrangements’), we consider that the conflicted remuneration provisions apply, where relevant, if:
- (a) a client is transferred into a new financial product by replacing their existing interest in a product with an interest in the new financial product on or after the application day; and
 - (b) conflicted remuneration is provided under the new product.
- 86 More than half the respondents on this issue disagreed with our proposed guidance. Instead, they submitted that whether a benefit is grandfathered depends on the features of the pre-existing arrangement and whether the benefit can be said to be given under that arrangement.

ASIC’s response

At the date of issue of this report, the Australian Government is consulting on regulations that will modify the scope of the transitional provisions in s1528(1) and reg 7.7A.16. We will update our guidance to take into account the effect of the regulations after they have been finalised.

However, to provide industry with some certainty about our approach in the interim period, we have provided further guidance on when changes to an arrangement may mean that an arrangement is no longer the arrangement that was in place before the application day, and benefits may no longer be grandfathered under the current provisions: see RG 246.201–RG 246.202.

Asset-based fees on borrowed amounts

- 87 A number of respondents commented that it would be helpful for ASIC to provide guidance on how the transitional provisions apply to the ban on asset-based fees on borrowed amounts.

ASIC's response

In response to requests for further guidance on this issue, we have included an example dealing with a product portfolio held by a client before 1 July 2013, where an adviser subsequently recommends taking out a margin loan to acquire products on or after 1 July 2013: see Example 17 of RG 246.

In our commentary on this example, we explain our view that the ban on asset-based fees on borrowed amounts does not apply to products acquired with amounts that were borrowed before 1 July 2013, but would apply to products acquired with amounts that were borrowed on or after this date.

H Benefits that are not conflicted remuneration

Key points

This section outlines the key issues raised in submissions on Table 4 in CP 189 and our responses to those issues.

It covers our proposed guidance on benefits given by a retail client.

Benefits given by a retail client

- 88 In Table 4 of CP 189, we stated that for the exclusion for benefits given by a retail client in s963B(1)(d) to apply where financial product advice is provided by a representative, the benefit must be given by the retail client to the representative.
- 89 Respondents thought that an AFS licensee who receives a benefit given by a retail client should be able to pass it on to their representatives.
- 90 They were concerned that the proposed guidance would prevent licensees from passing benefits along to their representatives, as the exemption would only apply to benefits received *directly* from the retail client. Respondents submitted that this would have a negative impact on risk management, operational efficiency and costs.

ASIC's response

We have clarified our guidance on the exclusion in s963B(1)(d) and 963C(e) to state that an AFS licensee who receives a benefit given by a retail client may pass it on to a representative in certain circumstances.

However, our view is that the exclusion in s963B(1)(d) and 963C(e) only applies where a client has given genuine, express and specific consent to a benefit being given. Therefore, we consider that:

- an AFS licensee may pass on a benefit, or a portion of a benefit, given by a retail client to an authorised representative or other representative under this exclusion if the client has authorised passing on the benefit in this way and the AFS licensee does not have discretion over the portion of the benefit passed on to the representative; and
- if the AFS licensee passes on the benefit, or a portion of the benefit, to an authorised representative, the authorised representative may subsequently pass that benefit, or a portion of it, to another representative of the AFS licensee (e.g. an employee of the authorised representative).
However, again, the client must have authorised passing on

the benefit in this way and the authorised representative must not have discretion over the portion of the benefit passed on to the other representative.

Our guidance on this issue is set out in RG 246.61–RG 246.66 and the appendix to RG 246.

Appendix: List of non-confidential respondents

- Abacus Australian Mutuals
 - AMP Financial Planners Association
 - AMP Financial Services
 - Andika Pty Ltd
 - Associated Advisory Practices
 - Association of Financial Advisers
 - Australasian Compliance Institute
 - Australian Bankers' Association
 - Australian Financial Markets Association
 - Boutique Financial Planners
 - CPA Australia/Institute of Chartered Accountants Australia
 - Financial Planning Association of Australia
 - Financial Services Council
 - Henry Davis York Lawyers
 - IG Markets
 - Industry Super Network/Australian Institute of Super Trustees
 - ING Direct
 - Institute of Public Accountants
 - Johnson Winter & Slattery
 - Law Council of Australia
 - McCullough Robertson Lawyers
 - McMahon Clarke
 - National Information Centre on Retirement Investments Inc
 - State Super Financial Services Australia
 - Stockbrokers Association of Australia
 - Vanguard Investments Australia
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