Final FOFA grandfathering regulations

1 July 2013

Regulations to restrict the grandfathering arrangements for conflicted remuneration under the Future of Financial Advice (FOFA) reforms were registered on Friday 28 June 2013. The regulations also provide for some additional grandfathering relief and exceptions to the ban on conflicted remuneration.

In this MASTech article we provide a broad summary of the background and application of these regulations which are effective from today.

Background

One of the key initiatives of the FOFA reforms is a ban on conflicted remuneration, broadly covering commissions and other payments that could reasonably influence the advice given to retail clients. It was acknowledged by the Government from the outset that payments of conflicted remuneration under existing arrangements should be grandfathered, meaning that such payments would be able to continue despite the new ban.

However, the Government came to the view that the effect of the grandfathering provisions which were put into place last year was broader than had been intended and had anti-competitive elements. In particular, the Government was concerned to ensure that, in line with Minister Shorten’s second reading speech, generally existing arrangements would not be grandfathered to the extent that they related to new clients and new products. Accordingly, following consultation on an exposure draft in March 2013, new regulations have been made which replace the existing conflicted remuneration grandfathering provisions. The final regulations reflect a number of differences from the exposure draft.

Application of the regulations

So far as the application of these new regulations is concerned, much turns on subtleties of the drafting so specialist legal advice should be sought to determine the effect on particular arrangements. Note that wherever this summary refers to 1 July 2013 it is assumed that no relevant entity adopted for FOFA to apply to it from an earlier date.

Generally a conflicted remuneration benefit given by one party to another under an arrangement entered into before 1 July 2013 (existing arrangement) is prima facie able to be paid at any future time (grandfathered), but then various regulations provide extensive exceptions or additional conditions in relation to new retail client business or new investments. These exceptions or conditions vary depending on whether the benefit was given by a party acting in the capacity as a platform operator or some other capacity (eg fund manager or dealer) and whether or not the recipient was an employee.

More specifically, the regulations set the limits on grandfathering of the following benefits.
The comments in the sections below provide further information in relation to these rules. Note however that the regulations also provide that, generally a payment by a licensee to acquire a representative’s financial advice business pursuant to a “buyer of last resort” arrangement will not be conflicted remuneration. The regulations also include a technical provision to preserve the grandfathering of benefits in certain situations where an arrangement is terminated because of the conflicted remuneration provisions and a new arrangement entered into on or after 1 July 2013.

Two Key Dates

The regulations come into force on 1 July 2013.

1 July 2013 is the application day of the conflicted remuneration bans for the vast majority of (if not all) entities (although, as indicated above, if an entity elected for FOFA to apply from an earlier date then that earlier date would be the application day). In most cases grandfathering of business-to-business (B2B) benefits is limited to those given under arrangements entered into before that date.

1 July 2014 is also a relevant date; grandfathering of various benefits is limited to clients, investments or employment arrangements made by that date.

Non-employee benefits

Except for certain employee benefits, only remuneration provided under an arrangement in place as at 1 July 2013 will attract the protection of grandfathering for conflicted remuneration. Where there is such an existing arrangement, in most circumstances grandfathering will apply to remuneration generated from a retail client who had invested in the relevant product before 1 July 2014.

Where there is an existing arrangement efforts may well be made in the next 12 months to acquire retail client business under that arrangement. Of course, anti-avoidance provisions and other FOFA requirements such as the best interests duty apply regardless of grandfathering.

New arrangements with product issuers or licensees/advisers on or after 1 July 2013 will need to be FOFA compliant and will not have the benefit of the extension to 1 July 2014.

Employee benefits

Again, 1 July 2013 and 1 July 2014 are key dates, but they operate in different ways depending on the nature of the employment arrangement, as described below.

Platform operator benefits

Broadly, a platform is a custodial arrangement such as an investor-directed portfolio service (IDPS) or a superannuation fund that offers to be the provider of a custodial arrangement. While not every product that is colloquially regarded as a platform is within that concept for the purposes of the grandfathering rules,
some of them may instead be covered under the rules as a “multi-product offering” so that the grandfathering rules apply in a reasonably similar manner.

Generally, the rules effectively provide that benefits paid in the capacity as a platform operator can continue to be paid under an existing arrangement in relation to an investment made via the platform by clients who have a platform account by 1 July 2014, including new investments or switches (including new contributions or rollovers or a transfer from accumulation to pension phase, in the case of a super fund made by these clients on or after 1 July 2014).

However, a benefit given by a platform operator acting in that capacity to another entity under an existing arrangement will not be grandfathered (assuming there are no constitutional grounds to claim grandfathering) if it:

- relates to an acquisition or retention of a financial product by a retail client who had not opened an account (or at least given instructions to do so) on the platform before 1 July 2014; or
- does not relate to a person who opened an account on the platform – an example of this may be a marketing or sponsorship payment from a platform operator to a dealer that is designed to incentivise the dealer to recommend the platform to its clients.

**Points to note:**

- This rule does not apply to remuneration arrangements between a platform operator and its employees.
- This rule does not apply to a benefit paid by an entity which operates a platform if the benefit is paid by the entity acting in some other capacity (e.g., if paid as a fund manager by an entity which is both a fund manager and platform operator).
- Benefits given by a fund manager with offerings on platforms are dealt with in later sections.
- If a party to the arrangement changes then the arrangement is nevertheless taken to continue for the purposes of grandfathering (e.g., the parties restructure for efficiency purposes or assign their rights under the arrangement to another party resulting in a change in parties), although the Explanatory Statement accompanying the regulations (ES) notes that restructuring simply in order to continue or increase grandfathered payments may attract the operation of the relevant anti-avoidance provision. The ES also notes that if “changes to an arrangement extend beyond a change to a party, the parties will need to give consideration to whether the changes are sufficiently material to trigger a new arrangement” – in other words, parties will need to rely on their own legal advice on that issue.

**Fund manager benefits to platforms**

The regulations do not address payments from fund managers to platforms (shelf space fees). An existing provision of FOFA provides for a benefit paid by a fund manager to a platform under an arrangement entered into before 1 July 2013 to be grandfathered.

This could be perceived to be an inconsistency in that the Government appears to be otherwise trying to prevent benefits under B2B arrangements from being able to be paid in relation to new retail investments under those arrangements. Nevertheless, we do not expect any further provisions to be introduced in relation to such a benefit.

**Fund manager benefits to dealers**

The rules generally provide that benefits paid by a fund manager under an existing arrangement in relation to the retention of an investment made by a client before 1 July 2014 are grandfathered.

A benefit given by fund manager under an existing arrangement will not be grandfathered (assuming there are no constitutional grounds to claim grandfathering) if it:

- relates to an acquisition of a financial product on or after 1 July 2014 for the benefit of a retail client (even if the investment was via a platform account that the client had held before 1 July 2014) who did not have an interest in the product before 1 July 2014; or
- does not relate to a financial service provided before 1 July 2014 for a retail client, such as a marketing or sponsorship payment from a platform operator to a dealer that is designed to incentivise the licensee to recommend the platform to its clients.

**Points to note:**
If a client of an IDPS or superannuation fund platform was to switch from an investment they held via the IDPS or superannuation fund before 1 July 2014 to one which they had not been invested in before that time, grandfathering will generally not apply to a benefit paid by the fund manager of the new investment to a relevant dealer. On this basis, fund managers sourcing money via an IDPS or superannuation fund may need to find out who old and new clients are, creating likely significant reporting demands on platforms.

Further, if some time on or after 1 July 2014 a client increases an existing interest (ie one held before 1 July 2014) in a relevant financial product they will not be taken to have acquired a new financial product, which means that the relevant fund manager can continue to pay conflicted remuneration under an existing arrangement in relation to such a client.

As with the rules on benefits paid by platform operators acting in that capacity:
- these exceptions do not apply to employee remuneration arrangements, which are dealt with under separate rules described later; and
- changes to a party of an arrangement is generally intended not to cease its grandfathering.

**Dealer benefits to non-employed advisers**

The rules generally provide that benefits paid by a dealer under an existing arrangement in relation to the retention of an investment made by a client before 1 July 2014 are grandfathered.

A benefit given by a dealer under an existing arrangement will not be grandfathered (assuming there are no constitutional grounds to claim grandfathering) if it:

- relates to an acquisition of a financial product on or after 1 July 2014 for the benefit of a retail client who did not have an interest in the product before 1 July 2014; or
- does not relate to a financial service provided before 1 July 2014 for a retail client – perhaps an example of this is a promotional payment from a dealer to an adviser that is designed to incentivise the adviser to recommend a particular product to its clients.

Again, a change to a party of an arrangement is generally intended not to cease its grandfathering.

**Pass through rule**

If a benefit paid by a dealer is not grandfathered under the rules described above, it may nevertheless be covered by the "pass through" rule. Under the pass through rule, if a benefit is paid by one party (eg a dealer) to another party (eg a non-employed adviser) under an existing arrangement, the benefit may be grandfathered provided:

- it is a “pass through” of a benefit received by the payer under another existing arrangement (eg with a platform provider);
- the benefit passed through is no more than 100 per cent of the original benefit; and
- the purpose of its payment is consistent with the purpose of the original benefit’s payment.

**Points to note:**

- Typically payments from dealers to advisers will be on the basis of the overall amount of funds held on a platform or multi-fund offering rather than the amount of funds invested in a particular financial product via the platform or multi-fund offering. That is, the relevant product will be the platform or multi-fund offering, not an individual investment made via it. Accordingly, it is expected that (either as a result of the general grandfathering rule applicable to dealer benefits or the pass through rule described above) even if a client who invested via the platform prior to 1 July 2014 subsequently switched investments or made a new investment (via the platform), a benefit paid pursuant to an existing arrangement between the dealer and the adviser would typically be grandfathered.

By contrast, if an existing arrangement between the dealer and the adviser was based on the amount of funds invested in a particular managed fund then a benefit would generally not be grandfathered if it relates to a different investment made on or after 1 July 2014.

**Benefits to employee advisers**

The grandfathering of employment arrangements can turn on whether or not the arrangement is an enterprise agreement (EA) or a collective agreement-based transitional instrument (CATI) in place as at 1 July 2013, as follows.
Employees engaged under an EA in place as at 1 July 2013

A benefit paid to an employee under a remuneration arrangement with an employer in accordance with an EA or CATI which was in place as at 1 July 2013 will be grandfathered until 1 July 2014 or until 6 months after the nominal expiry date of the EA, generally whichever is later. Employment benefits potentially may be grandfathered beyond that time under the pass through rule – refer below.

Points to note:
- This grandfathering can apply in relation to employees who entered a remuneration arrangement with an employer after 1 July 2013 (and even after 1 July 2014).
- This rule arose due to various employment law considerations.

Other employees

If an employee is engaged at any time before 1 July 2014 otherwise than under an EA or CATI which was in place as at 1 July 2013, then benefits paid under the employment arrangement are grandfathered until 30 June 2014. Employment benefits potentially may be grandfathered beyond that time under the pass through rule – refer below.

Point to note:
- This rule applies in relation to employees recruited both before and after 1 July 2013, up until 30 June 2014.

Pass through rule

If an employee was recruited before 1 July 2013 then benefits paid under an existing arrangement may be grandfathered if:
- they are a “pass through” of a benefit received by the employer who received the benefit under another existing arrangement;
- the benefit passed through is no more than 100% of the original benefit; and
- the purpose of its payment is consistent with the purpose of the original benefit’s payment.

Points to note:
- As the ES illustrates, an example of this is where a dealer receives a grandfathered benefit from a product issuer as a result of one its employees recommending one of the issuer’s products – the arrangement which gives rise to the original benefit is between the product issuer and the licensee. The dealer may pass the benefit on to its employee so long as the purpose of its payment is consistent with the purpose which gave rise to the original benefit, that is, for recommending the product issuer’s product.
- This does not apply to employees employed under arrangements entered into on or after 1 July 2013.

Asset-based fee ban

It is worth noting that the grandfathering of asset-based fees in relation to geared investments would be unaffected by these grandfathering regulations. That is, grandfathering will apply to fees charged on amounts borrowed before 1 July 2013 except that grandfathering will not apply to any fees charged in respect of financial products acquired on or after 1 July 2013 using borrowed funds.

Further information
- Corporations Amendment Regulation 2013 (No. 5)

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