"The Future of Financial Advice"

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1 Introduction

The Future of Financial Advice, or 'FOFA', amendments to the Corporations Act 2001 have had a significant impact on the financial services industry. Put simply, the FOFA changes put billions of dollars of revenue at risk for numerous participants in the industry. As a consequence, there are interested stakeholders at all levels of the business. Internal and external advisers have come under significant pressure to find solutions or endorse favourable interpretations of legislation, or draft legislation, or even media releases and commentary.

The FOFA amendments raise interesting jurisprudential issues which make for great debate amongst those practicing in the area. However, the purpose of this paper is a practical one: to focus on a few significant issues that have come up repeatedly in practice with regards to the FOFA legislation, and to explore how those issues might be resolved given the form and purpose of the amendments. In particular, the paper will focus on three issues relating to the conflicted remuneration provisions in Division 4 of Part 7.7A of the Corporations Act: the way that conflicted remuneration is defined, 'grandfathering' of conflicted arrangements, and the anti-avoidance provision that was introduced along with those provisions.

2 The relevant legislation

The Future of Financial Advice reforms to the Corporations Act 2001 prohibit financial services licensees and authorised representatives from receiving certain forms of remuneration, including conflicted remuneration (Division 4 of Part 7.7A). Volume-based benefits, which have been a relatively common remuneration structure in the financial services industry, are presumed to be conflicted remuneration, with the onus placed on the participants to the arrangement to rebut that presumption.1 However, to ensure that existing contractual relationships would not be adversely affected by the implementation of the conflicted remuneration provisions, there are transitional provisions in Part 10.18 which permit certain arrangements that would otherwise be prohibited under Division 4 of Part 7.7A to continue, subject to certain conditions. These transitional arrangements are commonly known as ‘grandfathering’ provisions.

The conflicted remuneration provisions in Division 4 are reinforced by an anti-avoidance mechanism in Division 6 of Part 7.7A which purports to operate to prohibit persons from entering into arrangements designed to avoid the operation of this new legislation. However, as this paper will discuss, how these three regimes operate together is not entirely clear from either the text of the legislation itself, or from the Explanatory Memoranda which accompanied the legislation when introduced.

3 The conflicted remuneration provisions

3.1 The scope of the definition

[1] Corporations Act 2001, section 963L

'Conflicted remuneration' is defined in the Corporations Act to mean '*any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given:*

(a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or

(b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.'[2]

There are a couple of salient points to note about the definition of conflicted remuneration:

- *it does not relate only to personal financial product advice – benefits received by a licensee or its representatives for giving general financial product advice can constitute conflicted remuneration. This has caused great angst amongst trustees of superannuation funds and responsible entities of managed investment schemes in particular, as they give general financial product advice to promote their products in a competitive market as well as to educate existing investors.*

- a qualitative judgment needs to be made as to whether a benefit received by a licensee or its representative will influence recommendations about financial products or advice given; and

[2] Corporations Act 2001, section 963A

- a benefit that a financial services licensee receives in respect of services provided to one set of retail clients can be conflicted remuneration if it influences the financial product advice given by the financial services licensee to another set of retail clients. In other words, it is not just the advice given that pertains to the benefit received by the licensee and representatives that may captured under the definition: any advice given that might be tainted by the receipt of the benefit needs to be considered.

The key to determining whether a benefit received by a financial services licensee is likely to be conflicted remuneration is therefore to look at the manner in which it is received, and consider objectively whether, in the circumstances in which the benefit is received, it is likely to influence financial product advice being given by the licensee.

3.2 When benefits are not passed onto an adviser

In its *Regulatory Guide 246: Conflicted Remuneration*, the Australian Securities & Investments Commission (ASIC) noted that some licensees receive benefits, which are often volume-based, from platform operators and other product issuers, but the licensees do not pass on these benefits, or any portion of them, to the individual representatives who provide the financial product advice to clients. Instead, the licensee uses the benefit to pay for its operating expenses. ASIC stated that it was less likely to scrutinise the benefit under the conflicted remuneration provisions if there are controls in place to ensure that the benefit does not influence the advice given by representatives of the licensee. It then gave an example of where it would not consider a benefit received by a licensee to be conflicted remuneration provided that:

- *no portion of the benefit is passed on to an individual that provides financial product advice to a retail client;*
- *the platforms and the products its advisers can recommend to clients are not selected based on the potential value of the benefit the licensee receives from the platform operator or other product issuer. For example, it could show this by demonstrating it has robust policies that are implemented and maintained for platform and product selection;*
- *it does not promote any specific platform or other product to its individual advisers or clients other than by way of general adviser education; and*
- *it makes available a diverse range of platforms and has an extensive list of products its advisers can potentially recommend to clients.* [3]

A number of licensees treated this position taken by ASIC as a 'no-action' position that ASIC was taking for benefits received by the licensee that are used to defray operating expenses. However, the example simply illustrates the central proposition of the conflicted remuneration provisions: a benefit will only constitute conflicted remuneration if it is likely, in the circumstances, to influence financial product advice given by the recipient of the benefit or its representatives. A benefit that a licensee receives from a product issuer is not likely to influence advice given by the advisers within a licensee if they do not know that the licensee is receiving the benefit, and the benefit does not in any way influence the licensee's

[3] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 123

conduct. However, if the licensee was to use the benefit to defray operating expenses, but then disseminated material internally to its advisers encouraging them to recommend the issuer's products, the benefit being paid by the product issuer is likely to influence the advice given by the advisers.

3.3 Approved Products List

To illustrate how the central proposition in the conflicted remuneration definition works, consider an example based largely on the same set of circumstances as those identified in ASIC's example, namely:

- there is a payment from the issuer to a licensee;
- the licensee uses the payment to defray expenses; and
- the payment is not passed onto the licensee's representatives in any way.

However, assume the issuer's product is added to the licensee's Approved Products List following receipt of the payment, and the Approved Products List is made up of products of issuers that have made payments to the licensee. The purpose of an Approved Products List is that it restricts the range of products available to the licensee's representatives to advise on: it is a term of their authorisation from the licensee that they are only authorised to advise on products on the Approved Products List.

The question arises whether, in the circumstances, the payment from the product issuer to the licensee has '*influenced'* the advice that the adviser will give to his or her clients. Returning to the definition of conflicted remuneration, the definition refers to '*the advice*' being given by the licensee or representative having been influenced by the benefit, not '*the adviser*' having been influenced by the benefit. This opens the possibility of the definition of conflicted remuneration capturing benefits that *indirectly* influence the advice given. In our example, it is arguable that the payment from the issuer to the licensee has shaped the Approved Products List, and as the Approved Products List restricts the advice the adviser can give, the payment has influenced the advice given, albeit indirectly.

To mitigate the risk of the benefit paid by the product issuer to the licensee being construed as conflicted remuneration, the licensee must be able to show that the financial product is on the Approved Products List for reasons other than the receipt of the benefit. For instance, some licensees will be able to adduce evidence to prove that an investment committee had approved the product for inclusion on the Approved Products List following a comprehensive review of the product which did not consider the receipt of the payment. Other licensees may be able to show that the issuer's product had been included on the Approved Products List before a payment was ever received from the issuer, and the continuing inclusion of the product on the Approved Products List was not in any way conditional upon the continuing receipt of further payments from the issuer. In those circumstances, the licensees and issuers might reasonably form the view that the receipt of the benefit had not influenced the advice given by the adviser, either directly or indirectly. However, if a licensee could not show that there was some basis for the issuer's product being included on the Approved Products List other than the receipt of the benefit, there is likely to be a significant risk that the benefit will be caught under the definition of conflicted remuneration.

3.4 Conflicted remuneration and corporate superannuation

Another scenario that has become increasingly common in the corporate superannuation space in particular is this:

- a licensee approaches a trustee and indicates that the licensee can deliver to the trustee an employer with hundreds or thousands of employees.

- the licensee indicates to the trustee that the employer will want its own sub plan within the fund, and the trustee agrees to that.

- the licensee says that the employer will want the licensee to be engaged to provide either general or intra fund advice to members of the sub plan. The trustee thinks that is reasonable: the licensee has a relationship with the employer and an understanding of its needs.

- the licensee and the trustee agree on a fee for the services that are to be provided by the licensee to the trustee. If the fee is a flat fee - so it is not volume-based - it will not be deemed to be conflicted remuneration. If the fee is priced on a cost recovery basis, it could be as modest as $100 per member per annum.

For the licensee, the payment from the trustee is not the end game: the main play is the access to the membership base of the employer sub plan. If those members want personal advice, either in relation to their interest in the fund or in relation to other matters, the licensee wants to have a relationship with the member, which it hopes will lead to the member engaging the licensee on a fee-for-service basis.

The licensee is therefore receiving payments both from the trustee in relation to the services arrangement, and from the client on a fee-for-service basis.

It is a common misconception for the trustee to consider that as it is not a retail client, and it is not receiving any personal advice from the licensee, the payment it is making to the licensee cannot be conflicted remuneration. The licensee, on the other hand, thinks the fact that the only payment it is receiving from a retail client is the payment received from the client under the fee-for-service arrangement, which is an exempt benefit, so it too is not receiving any conflicted remuneration.

However, the trustee and the licensee still need to consider whether the payment being made by the trustee to the licensee could influence the personal advice given by the licensee to other clients. Returning to the definition of conflicted remuneration, the definition does not just capture benefits that pertain to the advice being given by the licensee or representative: it captures any advice being given by the licensee or its representatives.

The trustee and the licensee therefore need to consider advice being given to clients that are not even covered by this arrangement. For instance, if the licensee and its advisers were to give 'switching' advice to their clients who are not already members of the employer's sub-plan set up within the trustee's fund, but which resulted in those clients becoming members of the sub-plan, there could be an argument that the payment from the trustee to the licensee has influenced that switching advice. The counter argument from the licensee and the trustee might be that the amount of payment is negligible, and therefore in the circumstances, it is not reasonably likely to influence any advice being given by the licensee. Again, one must return to the central proposition of the definition of conflicted remuneration, and consider what, if any, nexus there is between the receipt of the benefit and any advice or recommendations being given.

This analysis takes on even greater significance for the trustee if it has been authorised to offer a MySuper product under the *Superannuation Industry (Supervision) Act 1993*.[4] An RSE licensee that applies for authority to offer a class of beneficial interest in a regulated superannuation fund as a MySuper product is required to make an election that, if the authority is given, the RSE licensee will not charge any MySuper member a fee in relation to the MySuper product, all or part of which relates directly or indirectly to costs incurred by a trustee or the trustees of the fund:

(a) in paying conflicted remuneration to a financial services licensee, or a representative of a financial services licensee; or

(b) in paying an amount to another person that a trustee of the fund knows, or reasonably ought to know, relates to conflicted remuneration paid by that other person to a financial services licensee, or a representative of a financial services licensee.[5]

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[4] Superannuation Industry (Supervision) Act 1993, Part 2C

[5] Superannuation Industry (Supervision) Act 1993, section 29SAC(1)

'Conflicted remuneration' for the purposes of the MySuper election has the same meaning as in the Corporations Act,[6] except that it is extended for the purposes of the MySuper election so that it has the meaning it would have if:

(a) financial product advice provided to the RSE licensee by a financial services licensee, or a representative of a financial services licensee, were provided to the RSE licensee as a retail client; and

(b) financial product advice provided to the other person mentioned in subparagraph (b) above by a financial services licensee, or a representative of a financial services licensee, were provided to the other person as a retail client.[7]

This means that an RSE licensee, or any other person to whom the RSE licensee might make a payment (such as a financial services licensee), that would otherwise be a wholesale client for the purposes of the conflicted remuneration provisions in the Corporations Act, will be deemed to be a retail client for the purposes of the conflicted remuneration election in the MySuper application.

Financial product advice does not only cover advice relating to the acquisition of a financial product, but a decision in relation to a financial product. This means that advice given to an employer about superannuation arrangements for its employees could constitute financial product advice, even though the advice will not lead to the employer acquiring a financial product.

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[6] Superannuation Industry (Supervision) Act 1993, section 29SAC(2)

[7] Superannuation Industry (Supervision) Act 1993, section 29SAC(3)

For the purposes of the prohibition on the payment or receipt of conflicted remuneration in the Corporations Act, certain volume-based benefits are presumed to be conflicted remuneration if access to, or the value of, the benefit is dependent on:

(a) the total value of financial products of a particular class, or particular classes, recommended by the licensee or representative to retail clients or acquired by the retail clients to whom the licensee or representatives provide financial product advice; or

(b) the number of financial products of a particular class, or particular classes, recommended by the licensee or representative to retail clients or acquired by the retail clients to whom the licensee or representatives provide financial product advice.[8]

However, the deeming of volume-based payments as conflicted remuneration in the Corporations Act is irrelevant for the purposes of the MySuper election, as the election for MySuper purposes only picks up the definition of conflicted remuneration, and not the provisions which deem volume-based payments to be conflicted remuneration.

The trustee therefore needs to be comfortable that the payment it is making to the licensee under the services arrangement is not reasonably likely to influence any advice being given to retail clients by the licensee. A trustee dealing with a related party advisery business may have sufficient visibility and information about the advice business to make an informed

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[8] Corporations Act 2001, section 963L

judgment about this, but a trustee dealing with a third party licensee will rely heavily on the information it receives from the licensee to make this judgment. This reliance has its own inherent risks, because the licensee has a certain amount of self-interest in forming its view about whether the payment is likely to influence advice.

4 Grandfathering of conflicted arrangements

4.1 Background

The grandfathering provisions of the Corporations Act[9] provide that the prohibition on the giving of conflicted remuneration in Division 4 of Part 7.7A of the Corporations Act does not apply to a benefit given to a financial services licensee, or a representative of a financial services licensee, if the benefit is given under an 'arrangement' entered into before the application day.

For the purposes of the grandfathering provisions, 'application day' will generally mean 1 July 2013 (unless the relevant licensee or authorised representative elects to bring the date forward).[10]

4.2 What is an 'arrangement' for the purpose of the grandfathering provisions?

An 'arrangement' is not defined for the purposes of the grandfathering provisions. ASIC states in its Regulatory Guide 246 – *Conflicted remuneration* (**RG 246**) that an arrangement:

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[9] Corporations Act 2001, section 1528 (as modified by Corporations Regulation 7.7A.16*)*

[10] Corporations Act 2001, section 1528(4)

> *'is defined broadly. It generally means a contract, agreement, understanding, scheme or other arrangement as existing from time to time, whether it is:*
>
> *(a) formal or informal, or partly formal and partly informal;*
>
> *(b) written or oral, or partly written and partly oral; and*
>
> *(c) enforceable, or intended to be enforceable, by legal proceedings (or not), and based on legal or equitable rights (or not): s761A.'*[11]

ASIC provides an example of such arrangements as 'agreements from a product issuer to pay an AFS licensee ongoing and upfront commissions'.[12] ASIC goes on to state:

> *'To determine whether a benefit is given under an arrangement entered into before the application day and is therefore grandfathered, it is necessary to determine under what arrangement the benefit is given and the terms of this arrangement. This includes:*
>
> *(a) when the arrangement was entered into;*
>
> *(b) what benefits are to be given and received under the arrangement;*
>
> *(c) who gives and receives a benefit; and*

[11] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 191

[12] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 192(b)

(d) whether the form and value of the benefit is specified in the arrangement or is discretionary.'[13]

The concept of an arrangement is not something that lawyers are as familiar with as concepts of contract or agreement. However, on the basis of the criteria set out by ASIC (which looks entirely reasonable), any arrangement where a party can prove there is a discernible, enforceable right to a benefit is likely to be considered an 'arrangement' for the purposes of the grandfathering provisions.

Where there is a written agreement or other documentation in place, it will generally be easier to determine whether a party has such a right. However, it has become quite apparent over the last few years that issuers and licensees do not always have such agreements in place (despite their best endeavours to find them!). A common industry practice for the payment of commissions was for an issuer to make a commitment in a Product Disclosure Statement or other document to pay commission from its own remuneration to advisers that arrange for their clients to acquire the issuer's products. An adviser may, on the basis of this invitation, approach an issuer and offer to deliver its client base to the issuer if the issuer makes good on its representation in the offer document to pay the commission. The issuer agrees to do this and each party makes good on its commitments. In these circumstances, there is a discernible arrangement in place which has all the required hallmarks of a contract. The benefits payable by the issuer will most likely be grandfathered.

[13] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 193

A less straightforward example is where there is no written representation or offer by the issuer to make the payment, but only a course of conduct whereby an issuer makes periodic payments of a certain amount to an adviser for each of the adviser's clients that is a member of the fund. In these circumstances, as in any contractual analysis, it may be difficult to establish the exact terms of the arrangement. However, if the parties can agree and establish, through evidence, the key terms of the arrangement (such as the amount of the payment, the frequency of the payment and its purpose), there is likely to be an *arrangement* for the purposes of the grandfathering provisions.

4.3 Amendment/variation of grandfathered agreements

The grandfathering provisions will apply to arrangements entered into prior to 1 July 2013 until such time as there is a material change to the arrangement which could be construed as resulting in a new arrangement being formed. This would include any subsequent arrangement that resulted in rights under the original arrangement being assigned or novated (for example, because an adviser moved from being the representative of one licensee to another licensee and the payment of a benefit under a grandfathered arrangement followed the adviser).

The ordinary principles of variation/amendment of contract will apply to the variation of grandfathered arrangements, such that:

- any changes to the parties to an agreement will result in the grandfathered agreement being terminated and a new agreement being formed. The grandfathering provisions would not apply to the new agreement; and

- variations or amendments to an agreement that substantially alter the rights and obligations of the parties to the agreement may be construed as bringing the grandfathered agreement to an end and commencement of a new agreement. The parties may argue that there was no intention to abrogate the grandfathered agreement and replace it with a new agreement, but a court may construe this as having happened as a matter of law if the terms of the varied agreement are so far inconsistent with the original agreement as to 'destroy its substance'[14].

It would not be surprising for ASIC to take the view a grandfathered agreement has been terminated if a practice develops in the market whereby material changes are made to the substantive terms of the grandfathered agreement (particularly in relation to the obligations of the distributor, etc) which would ordinarily involve the negotiation and execution of a new agreement, but the parties seek to argue the grandfathered agreement remains on foot in order to retain the benefit of the grandfathering provisions. However, changes to commercial terms of a grandfathered agreement that are specifically contemplated by the agreement (eg, changes to fees payable that are made following a periodic review contemplated by the agreement) would not result in termination of the grandfathered agreement. Nevertheless, the parties would still need to consider whether, notwithstanding that the agreement had not terminated, the *arrangement* under which the grandfathered benefit was being paid had changed to such a degree that it constituted a new arrangement.

[14] See Cheshire and Fifoot, 'Law of Contract', Seventh Australian Edition, at page 765

It should be noted that the legislation relating to grandfathering specifically provides for changes of a party to an arrangement.[15] Assignment or novation of grandfathered arrangements is therefore contemplated by the legislation, presumably so that books of business can be sold from one licensee to another by the usual mechanism of novation of rights. An issue that has often arisen during the recent period of consolidation of super funds and plans, whether by way of merger or successor fund transfer, is whether grandfathering would still apply to an arrangement that was novated or assigned where, as a result of the transaction, the member was issued with a new interest, such as in a successor fund transfer. The legislation does not specifically state that grandfathering will cease to apply where the member ceases to hold the financial product to which the arrangement relates.[16] In a successor fund transfer, where the member is issued with a new interest as a matter of law to, effectively, replace the interest they had in the transferring fund, and the member does not make an investment decision, there is an argument that the arrangement 'follows the member', so to speak, and is the same arrangement that was agreed to by the adviser and the transferring trustee. However, this position could be harder to argue after 1 July 2014, because the grandfathering legislation specifically provides that grandfathering does not apply to the issue of interests to persons after 1 July 2014 that did not hold an interest in the financial product before 1 July.

[15] Corporations Regulation 2001, regulation 7.7A.16E

[16] A draft regulation - Corporations Regulation 7.7A.4.16 - was released by Treasury for consultation in March 2012 which confirmed that grandfathering of an arrangement would not apply where a new financial product was issued, but that regulation was not registered, and the current regulations are silent on the issue in relation to the period until 1 July 2014.

5 The anti-avoidance provisions

5.1 Background

An anti-avoidance provision was introduced along with the prohibitions in Division 4 (Conflicted Remuneration) and Division 5 (Shelf-Space Fees) and became effective from 1 July 2012. However, unlike the prohibitions in Divisions 4 and 5, the 'application day' of the anti-avoidance provision was not deferred to 1 July 2013 by subsequent regulation.

A common query from licensees and authorised representatives seeking to determine the impact of the conflicted remuneration prohibition on their business, and to ensure they comply with the law from 1 July 2013, is: 'How does the anti-avoidance provision work?'.

The anti-avoidance provision states that, 'a person must not, either alone or together with one or more other persons, enter into, begin to carry out or carry out a scheme if:

(a) it would be concluded that the person, or any of the persons, who entered into, began to carry out or carried out the scheme or any part of the scheme did so for the sole or dominant purpose of avoiding the application of any provision of this Part in relation to any person or persons (whether or not a person or persons who entered into, began to carry out or carried out the scheme or any part of the scheme); and

(b) the scheme or the part of the scheme has achieved, or apart from this section, would achieve, that purpose.'[17]

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[17] Corporations Act 2001, section 965(1)

The operation of this provision is subject to the exception (which appears in many places in Part 7.7A) that it will not apply if it would result in the acquisition of property from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Commonwealth constitution).

A person looking to the Explanatory Memoranda to the Future of Financial Advice legislation for guidance on how the anti-avoidance provision is intended to work would largely come away empty handed. In light of this, where might one go for guidance on how to ensure one is not engaging in conduct which constitutes anti-avoidance?

5.2 The anti-avoidance provisions in tax law

Tax advisers are well familiar with an anti-avoidance provision, as they have been advising on the possible application of the anti-avoidance provisions of the tax law contained in Part IVA of the *Income Tax Assessment Act 1936* for many years. The aspect of the anti-avoidance provisions in the tax law that most lay people (and some lawyers) find both confusing and concerning is that a taxpayer can comply with the tax law and still breach the anti-avoidance provisions.

The anti-avoidance provisions in Part IVA of the 1936 Act are quite extensive. However, the Australian Taxation Office has stated that it interprets the provisions of Part IVA on the basis of two questions:

(a) Did the taxpayer obtain a tax benefit from a scheme that would not have been available if the scheme had not been entered into?

(b) Would it be objectively concluded that the taxpayer or any other person entered into or carried out the scheme, or any part of it, for the sole or dominant purpose of obtaining the tax benefit (having regard to the eight matters specified in Part IVA)?[18]

If the answer to both of those questions is 'Yes', then the ATO considers that the taxpayer can be in breach of the anti-avoidance provisions in Part IVA, *notwithstanding that they have otherwise complied with tax law*.

It is noteworthy that the drafting of the anti-avoidance provision in Part 7.7A of the Corporations Act in relation to conflicted remuneration and other forms of banned remuneration is remarkably similar to this position taken by the Australian Taxation Office in relation to the interpretation of Part IVA of the 1936 Act. If that was the case, it would suggest that the Parliamentary drafters did not look to the terms of the anti-avoidance legislation in the tax law, but to the way the Australian Taxation Office interprets the legislation, when they drafted the anti-avoidance provision that now appears in Part 7.7A of the Corporations Act. This would be of concern, because the provisions of Part IVA establish a number of objective measures that a taxpayer can use to determine whether its conduct is likely to infringe the anti-avoidance provision. The anti-avoidance provision in section 965 has no such objective measures, and is much poorer legislation for it.

Further, the ATO's interpretation of Part IVA requires a person to have obtained 'a benefit' from restructuring in order to breach the anti-avoidance provisions. Section 965 doesn't

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[18] Australian Taxation Office NAT 14331-12.2005

require that a person has obtained 'a benefit' from the restructure. On the face of it, if a person enters into a scheme to avoid the operation of the conflicted remuneration provisions by, say, winding up their company and retiring from the financial advice industry altogether, they could nevertheless be in breach of section 965.

5.3 *Is Part IVA relevant to an interpretation of the anti-avoidance provisions?*

Apart from the difference in the wording of the law referred to above, there is another very good reason why the anti-avoidance provision in section 965 should be interpreted quite differently to how both the courts and the Australian Taxation Office have interpreted Part IVA, and that is because there is a fundamental difference in the conduct each provision is intended to regulate.

The anti-avoidance provision in tax law applies to conduct voluntarily entered into by taxpayers to avoid the operation of the tax law. A taxpayer can generally do nothing and pay a higher rate of tax and they will not be in breach of the tax law. The anti-avoidance provisions in tax law are designed to capture people who voluntarily restructure their affairs to pay a lower rate of tax. However, the anti-avoidance provisions in the FOFA amendments must operate differently, because many licensees will breach the new legislation if they do nothing. In practical terms, it is not open to them to simply do nothing and pay a higher rate or penalty.

Take an example:

- a person makes widgets. In the course of making widgets, the widget maker generates revenue. The revenue is subject to income (and other tax) under tax law.

The widget maker may, reasonably, wish to restructure his affairs to pay less tax, but he doesn't have to: he can comply with the law by paying the tax that is levied on the revenue. It is understandable that law-makers enacted an anti-avoidance provision in the tax law in this context, because if the widget maker restructures his affairs to pay less or no tax, he is doing so voluntarily to gain an advantage.

- a financial adviser gives advice to clients. In the course of giving advice, the adviser generates revenue from third party sources that pay her to recommend their products. She has built her business exclusively around generating revenue from third party sources, because it allows her to give advice to her clients without having to charge them. Under the Future of Financial Advice reforms, however, the revenue is subject to the prohibition on the receipt of conflicted remuneration. The adviser cannot simply pay a tax or levy and move on with her business: she is prohibited from accepting it. If she doesn't restructure, she has to send everyone home and close the doors.

The point is this: many in the financial services industry have to restructure to comply with the FOFA reforms. It is implicit in the timing of the legislation itself, and the Federal Government's statements about the implementation of the legislation, that the application of the provisions has been delayed to give the industry time to restructure. So, in light of that, what can a licensee do to restructure without falling foul of the anti-avoidance provisions?

5.4 Restructuring to comply with the law

In its Regulatory Guide on conflicted remuneration, ASIC makes two main points about how it intends to administer the anti-avoidance provisions:

- it is more likely to scrutinise schemes that appear to have no commercial purpose other than to avoid the application of the conflicted remuneration provisions;[19] and
- it is unlikely to take action on arrangements that have been genuinely entered into to comply with the conflicted remuneration provisions.[20]

The first point is not particularly helpful. The main 'commercial' purpose for most licensees and authorised representatives restructuring is because they will breach the law if they do not! Unlike in tax law, a person that is receiving conflicted remuneration cannot do nothing because, after 1 July 2013, they will be in breach of the law. However, it is the second point raised by ASIC that is of the most comfort, because it reflects a position that was not apparent in the text of the anti-avoidance provision itself. Section 965 states that a person can have engaged in avoidance if they restructure to avoid *any* provision of Part 7.7A, yet in most cases, some restructuring will be required by licensees to avoid breaching Part 7.7A.

In the context that some restructuring of arrangements will have to occur in many circumstances, what is likely to be permissible? Let's consider some examples:

- **A licensee restructures to redirect the payments it is receiving in respect of retail clients:** a licensee that receives commissions from product issuers for giving advice

[19] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 218

[20] Australian Securities & Investments Commission Regulatory Guide 246 at paragraph 228

to retail clients sets up a special purpose company and directs the payments to that company instead. By directing the payment to a company that either doesn't provide financial services at all, or doesn't give advice to retail clients, the payment has been taken out of the definition of conflicted remuneration in section 963A. ASIC says in RG 246 that this is an example of an avoidance scheme, because 'in the circumstances and in the absence of another commercial purpose, it could be concluded that the payment was made to the special purpose AFS licensee for a purpose (that is not incidental) of avoiding the application of the conflicted remuneration provisions'. It is hard to argue otherwise, because the licensee has largely restructured so it can continue to receive the same payments in respect of retail clients that it did before the structure, but in a different manner. It has tried to change the structure of the arrangement, without changing its substance. There is no genuine attempt to comply with the law.

- **A licensee restructures so that it will continue to accept commissions only in respect of wholesale clients:** this is different from the scenario above in one significant way: the licensee is no longer taking commissions in respect of retail clients. The whole purpose of the FOFA reforms was to restructure the way financial advice is given to retail clients. If a licensee stops taking commissions in respect of retail clients but continues to do so in respect of wholesale clients, it is unlikely that could be considered restructuring to avoid the application of Part 7.7A, but rather restructuring to comply with Part 7.7A. (The outcome may be different if it had not taken commissions from wholesale clients in the past but only started doing so after the restructure).

- **A licensee restructures so that a payment will fall within an exemption:** another form of restructure that is commonly being discussed is making everything 'fee-for-service' (ie, having clients agree to or authorise the relevant payments). A payment that is authorised by the client for advice given to the client by an adviser, or for products and services given to the client by an issuer, is exempt from being conflicted remuneration.[21] This is consistent with the underlying purpose of the FOFA reforms: that retail clients should not only know what payments are being made to their advisers, they should authorise them. However, strictly speaking, such a restructure has been undertaken to avoid the application of Part 7.7A, and there is no other commercial purpose for doing it. It would be ludicrous for a licensee that changed its business model from operating on trail commissions to operating on a 'fee-for-service' model to be guilty of avoidance. In the author's opinion, this should not be considered avoidance, but rather restructuring to comply with the law (subject to the consent obtained from the client being express, informed consent).

- **A licensee 'restructures' so that a payment will be grandfathered:** prior to 1 July 2013, many licensees inquired whether they could 'restructure' their contractual arrangements to come within the grandfathering provisions. In some respects, one cannot really 'restructure' to come within those provisions: either there is an existing 'arrangement' in place (which is grandfathered) or there is not. The licensee can continue to enter into new arrangements in the ordinary course of business (that is not avoidance) or it can clarify the terms of existing arrangements with product issuers by

[21] Corporations Act 2001, section 964(1)(d)

documenting them (which should not be avoidance either, because it is documenting rather than changing the arrangement). And any substantial ‘restructuring’ of the arrangement is likely to result in a new ‘arrangement’ being formed in any event, with the effect that grandfathering will not apply.