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Composer FoFA Readiness Review

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Greek doing, action

Modern 1. the exercise of an art, skill or science. 2. The exemplary joining of theory and action into practice

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1 Introduction & Brief

GBST have commissioned Praxis Partners to review the appropriateness of GBST's preparation and introduction of changes to the Composer administration system which will, or may be, required under the *Future of Financial Advice* ("FoFA") legislative amendments as proposed by the Australian Federal Government.

1.1 Brief & Process

The purpose of this paper is to review the requirements and preparation of Composer for the introduction of changes to be implemented under the FoFA reforms as it relates to users of the Composer system and their requirements.

Praxis Partners has prepared this report based on multiple interviews and demonstrations with key GBST staff, platform & product providers and users of the Composer system to articulate the capability of Composer in regard to FoFA and any further requirements as espoused or suggested by users and platform providers.

Organisations and users of the Composer system have come from a wide range of financial services businesses that utilise Composer across a number of different segments and in a number of different ways and degrees of functionality usage. These businesses include "traditional" wrap platform providers, integrated platform and adviser "front-end" providers and business to consumer "direct" product providers.

2 About GBST

GBST is listed on the Australian Stock Exchange and provides global technology services to the financial services industry across a number of segments including:

- Australian broker services – equities and derivatives transaction processing, client accounting, settlement and clearing platform for institutional and retail brokers.
- Global broker services – Next-generation technology to process equities, derivatives, fixed interest and managed fund transactions for global markets participants.
- Wealth management – Funds and investment administration and registry software to the Australian wealth management industry with a growing presence in the United Kingdom.
- Financial services – Wholesale provider of access to financial products and related data information transactions for financial advisers and institutions and web design and web development services.

InfoComp, the developer of the Composer system was acquired by GBST in 2007 and has become GBST's Wealth Management division which has a presence in both Australia and the United Kingdom.

2.1 About Composer

GBST Composer offers a *“single fully integrated system to administer managed funds, structured products and retirement products”*.

Composer encompasses functionality which provides administration and registry platform services as well as CRM, imaging, workflow, STP, online capabilities and comprehensive reporting for servicing investors and advisers. It is capable of administering a wide variety of products available in the marketplace including:

- | | |
|---|---|
| ➤ Wraps | ➤ Life products |
| ➤ Superannuation – corporate & personal | ➤ Risk products |
| ➤ Pensions | ➤ Loans |
| ➤ Unit Trusts – retail & wholesale | ➤ Cash management (including term deposits) |

3 FoFA requirements

The Australian Government first proposed regulatory changes to the financial advice process in April 2010. In the intervening period, whilst the spirit of the changes have not materially changed (that is, to strengthen consumer trust and confidence in the financial planner industry and provide transparency for consumers), the legislation and regulations surrounding the FoFA bills have changed.

At the time of writing the legislation had passed the House of Representatives and had been passed by the Senate, after which time Royal Assent would be sought and the legislation enacted. The biggest change in the legislation, at the time of passing the House of Representatives, was the introduction of a twelve month transition period from the commencement date of 1 July 2012 with mandatory compliance with the legislation from 1 July 2013. Additionally, advisers who are subject to an ASIC approved industry Code of Conduct/Code of Professional Practice may be exempted from the proposed opt-in requirements.

There is some outstanding detail required from the legislation in the form of the finalised regulations which are due to be released prior to commencement of the Act.

The FoFA legislation, as passed by the House of Representatives and Senate, contains a number of pertinent areas of legislative impact:

1. Ban on conflicted remuneration for AFSL holders and their Authorised Representatives where advice is given to retail clients including a ban on commissions on risk insurance products within superannuation;
2. Fee disclosure regime and granularity of information provided to consumers of financial advice services;
3. Implementing a time limit on the period in which financial advice fees may be charged to consumers of financial advice services; and
4. Abolition of the charging of asset based fees on borrowed/geared investment amounts.

In addition to the above, the FoFA legislation introduces a number of other measures of no less importance but which do not appear to impact on the ongoing development or use of Composer by clients. These include:

- Introduction of a best interest duty for financial advisers;
- Banning of volume based payments and soft dollar benefits (of over \$300) to dealer groups or authorised representatives; and

- ▶ Various matters pertaining to scaled advice, advice provided by accountants and intra-fund advice.

3.1 Differing service models

Given the differing models of platform/product provision which exist in the Australian market place providers are in a number of camps with regard to the capture, recording and reporting of data required under the FoFA provisions.

Some providers, including dealer groups and financial advisers, who operate in a more vertically integrated model will look to other systems such as commercially available “front-end” systems to capture much of the FoFA required data whilst others, involved more in the pure administration of client accounts will look towards system providers, such as Composer, to provide this functionality.

Intuitively, those advisers/financial planning practices that have largely concentrated their business around a single preferred platform/product provider will be in a better position to leverage functionality within the system underpinning their preferred provider whilst those who utilise multiple providers and/or have a combination of platform and other (direct, for example) investment products may find more “front-end” positioned systems more relevant.

Having made this distinction it is clear however, that platform providers and the systems underpinning their services will be required to provide necessary FoFA functionality in their systems with some more vertically integrated model adherents possibly requiring data interface and data population between front-end systems and underlying registry systems.

4 Composer Readiness

The key questions for both GBST and users of the Composer system in relation to the applicable FoFA reforms are fundamentally:

- › What level of fee transaction granularity can be provided by product providers to enable advisers to meet the fee disclosure requirements of FoFA?
- › How can data regarding which clients have opted-in to a fee charging arrangement be recorded and where?
- › What reporting requirements will be needed by advisers to maintain their register of “opted-in” (and out) clients?
- › What functionality can be implemented to ensure that clients that have “opted-out” do not have advice fees deducted from their account and paid to and adviser/dealer group?
- › Can a platform provider adequately distinguish between risk insurance contracts “within” and outside of superannuation and not charge advice fees on those risk insurance products within superannuation (as defined by FoFA)?
- › Can, or does, the platform provider distinguish between asset based fees charged on “invested” amounts and “borrowed” amounts and not charge the applicable fees on those borrowed or geared amounts?

4.1 *Fee transaction granularity*

Composer has extensive functionality in its disbursement module/engine and associated business rules. This engine handles the movement of money between any parties within Composer (such as a client account and adviser).

It encompasses rules which deal with when a fee is triggered, either by way of batch run or the instigation of a transaction, when a fee is effective from (and to) and whether various selection criteria apply such as account balance limits or, potentially in the case of FoFA, whether some regulatory criteria is met.

Fees can be based on a number of scenarios including flat dollar fees, percentage based fees, prorated entitlements and scaled or tiered structures and can be set a any number of levels within Composer from funds and sub-funds through product and investment options to investor accounts or adviser/dealer group client groupings.

This functionality will allow Composer and its users to adapt or modify (where required) any of the fees charged by providers using Composer to comply with the proposed FoFA requirements.

Having been able to structure fees within applicable products/platforms users will be able to utilise Composer’s reporting tools to extract fee information and report those details to clients.

Composer’s reporting framework encompasses four levels of data extraction and reporting capability.

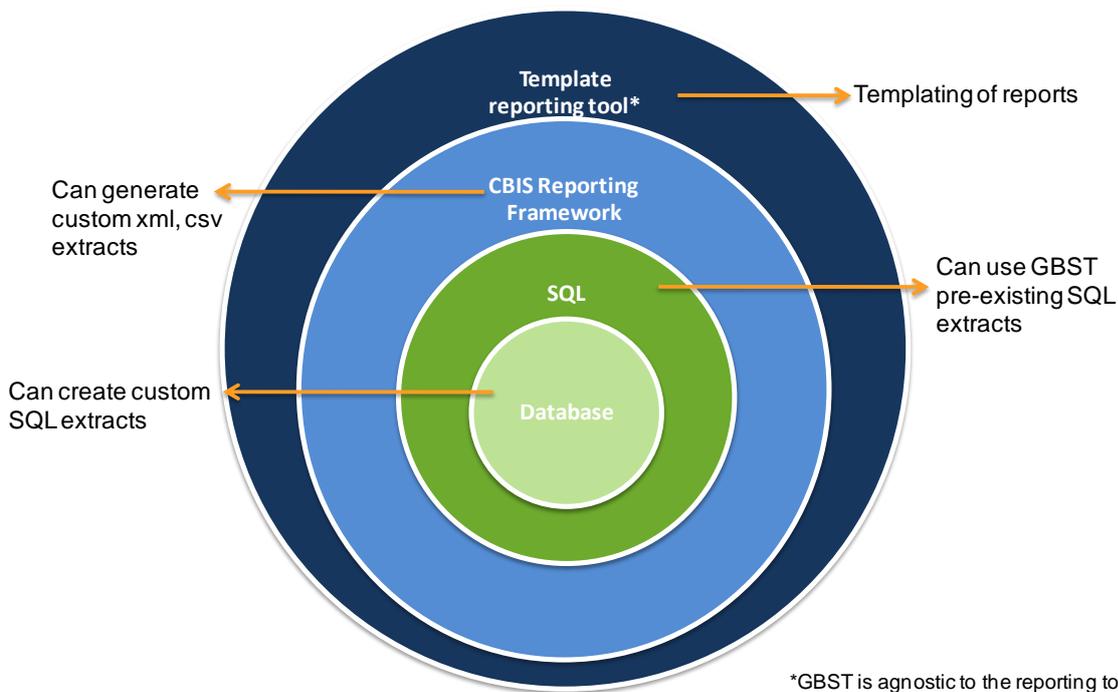


Figure 1: Composer Reporting Framework (Source: GBST)

It is expected that once final FoFA requirements receive Royal Assent standardised reporting tools (and data extraction formats) will be available to users to enable them to meet their FoFA requirements.

4.2 Opt-in requirements

The opt-in requirements under FoFA have, in many senses, been given the most amount of coverage compared to other regulatory changes.

There are currently some uncertainties surrounding the opt-in regime - none-the-least of which is the recording, administration and operation of any ASIC registered industry code of conducts or codes of professional standards which can be used by advisers to gain an exemption from this provision (under S962CA).

However, should the majority of advisers/dealer groups adhere to, or fall under, a code of conduct product and platform providers will still most likely need to provide some level of functionality around the recording and reporting of a client’s wish to opt in or out of a fee charging arrangement.

At the barest level a platform/product provider will need to record whether an advice fee can be deducted (and paid) from an investment account and when that choice expires (and henceforth cease deducting and remitting any advice fee). It will also need to record whether an account or client has been grandfathered and the extent to which an account has been grandfathered (what happens to new “contributions” post the start date of FoFA? Presumably a “whole” account will be grandfathered).

For this reason GBST will need to provide these facilities to users of Composer.

Given the flexibility contained within Composer’s disbursement module and the level of granularity provided to users in the configuration and administration of fees within Composer it would not appear to be a difficult nor extensive task to finalise a compliant approach to these FoFA requirements.

In our discussions with Composer users some expressed a desire to hold this opt-in information at a level “closer” to the client/adviser (meaning in some other front-end system) but with the potential ability to feed this data back into Composer to ensure that the system that actually calculates and deducts the adviser fee from investors is fully up to date with an adviser’s information. The adoption of a process such as this would streamline the administration of any opt-in requirement.

In addition to the recording of opt-in information Composer will need to provide users and downstream dealer groups and adviser with the ability to extract pertinent information on those clients whose opt-in arrangements are nearing the end of a period (two years) and require re-establishment/renewal. Given the extensive reporting functionality contained in Composer it is expected that this information will be easily accessible to dealer groups and advisers. In this regard the ability of Composer through various connectivity options, web services and straight-through processing capability will provide users with the ability to have Composer linked with other up, or down, stream systems whether or not Composer is required to be the source of truth for this information or not.

4.3 Conflicted remuneration

The ban on conflicted remuneration applies at a number of levels, all of which Composer is comfortably able to handle.

Firstly, remuneration based on the total value or number of products recommended or the total value of investments made by a retail client is banned. Composer’s ability to itemise and categorise all fees charged to a client will enable users of Composer to adequately identify and categorise fees or charges to ensure compliance with FoFA.

Secondly, Composer’s capability in administering both group risk insurance and stand-alone risk insurance products (through Composer Life) will also allow users to

meet their FoFA requirements. The focus of FoFA in this regard is group risk insurance products which are available to and “bundled” with superannuation platform offers.

Composer offers the functionality, through its disbursement engine discussed above, to be able to regulate/turn off commission payments on these risk insurance policies in a relatively simple manner.

Whilst full details of the grandfathering arrangements under final FoFA legislation is still a little unclear Composer is capable of identifying clients, accounts or individual transactions which would fall either side of any effective date of a grandfathering requirement.

4.4 Geared/borrowed amounts

The prospective ban on asset-based fees applying to borrowed, or geared, investment amounts will apply only to that portion of the investment which is borrowed (and hence, not the investor’s capital contribution). Additionally, it appears at the time of writing that this ban will not apply where a product is “internally” geared or the portfolio contains a level of gearing instituted by the product manufacturer.

From Composer’s perspective, and depending upon whether advisers wish to charge an asset-based fee on a non-geared portion of a client’s investment, it may need to do nothing.

The implementation of this restriction, whilst in good intention, may be problematic where an adviser does wish to charge an asset-based fee on the investor’s capital contribution but not on the borrowed amount. This is due to the fact that the sources of borrowing can be many and varied including margin lending facilities, personal loans, equity lines of credit and other vehicles. The difficulty here is not necessarily in the recording of a “borrowed” amount but in the timeliness and accuracy of them data recorded as the level of borrowed funds may change daily depending upon its source and issues such as capitalisation of interest and repayments and further draw-downs.

It may be the case that, for compliance and simplicity reasons, advisers, their dealer groups and their product and platform suppliers limit the type of fee charged to these clients and only permit non-asset-based fees to be charged.

4.5 Summary & conclusion

We are comfortable that, across the spectrum of Composer users, and given the modularity and flexibility of Composer that GBST has a product in Composer which will enable current and future users of Composer to adapt their product,



administration and operational procedures as well as interaction and servicing of AFSL holders and representatives to the “new world” under FoFA.

Whilst there are still a number of outstanding clarifications required from a legislative perspective GBST has considered an planned for various outcomes in this regard which will provide full compliance with final legislation.

Throughout discussions with both GBST staff and Composer users a key theme that emerged in relation to adapting to the new regulatory regime was flexibility and configurability – both elements which Composer has been developed and built around.

5 About Praxis Partners

Praxis Partners is a financial services consulting business which has been in operation since 2000. Founded by its principals Kieren Dell and Stuart Milne Praxis Partners assists financial services organisations across the market including:

- › Fund managers
- › Life insurance companies
- › Banks
- › Financial services software providers & developers
- › SMSF service providers and administrators
- › Industry associations & representative bodies
- › Dealer groups & licensees
- › Administrators
- › Wealth management organisations
- › Managed account/SMA/IMA providers

Our practical solutions and industry experience cover a wide range of areas, including:

- › Research, design and development of financial products, including wrap accounts, master funds, superannuation funds, unit trusts and retirement income streams
- › Assistance with strategic product and marketing issues
- › Assistance with the product management of financial services products and services, including mentoring of product managers
- › Market analysis and identification of trends and future opportunities
- › Outsourcing strategy & management of tender/RFP processes
- › Development and analysis of general business plans
- › Development of communications materials, including prospectuses/product disclosure statements/information memorandums and other offer documents and client newsletters
- › Management and coordination of product development, product rationalisation, regulatory implementation and systems projects
- › Technical consulting, including strategic analysis
- › Administration and operational reviews