Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019

Paula Pyburne
Law and Bills Digest Section

Contents

Purpose and structure of the Bill ........................................... 3
Background ........................................................................... 3
Ripoll Report ........................................................................ 3
Future of financial advice reforms ................................... 4
FOFA 1 Bill ........................................................................ 5
FOFA 2 Bill ........................................................................ 5
About conflicted remuneration ........................................ 5
Report of the Parliamentary Joint Committee ............ 6
FOFA Bills as enacted ...................................................... 6
FOFA 1 .............................................................................. 6
FOFA 2 .............................................................................. 7
Transitional provisions .................................................. 7
Coalition election commitment .................................. 7
Abbott government amendments ................................ 7
Streamlining FOFA Bill 2014 .......................................... 7
Streamlining Regulations ............................................... 8
Table 1: FOFA Regulations ........................................... 9
Effect of the Financial Advice Measures Act .......... 10
Monetary benefit that is not conflicted remuneration .............. 10
Other exceptions ............................................................ 10
Comments by the Royal Commission .................. 11
Grandfathered commissions ........................................ 11
Committee consideration .......................................... 12
Senate Standing Committee for the Selection of Bills ............. 12
Senate Standing Committee for the Scrutiny of Bills ................ 12
Policy position of non-government parties ............ 12

Date introduced: 1 August 2019
House: House of Representatives
Portfolio: Treasury
Commencement: Sections 1–3 on Royal Assent; Schedule 1 on 1 January 2021.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through the Australian Parliament website. When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.

All hyperlinks in this Bills Digest are correct as at September 2019.
Purpose and structure of the Bill
The purpose of the Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 (the Bill) is to amend the Corporations Act 2001 to:

• remove the grandfathering arrangements for conflicted remuneration in relation to financial advice provided to retail clients and
• establish a scheme by Regulation under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected customers.

The Bill has two Parts, each of which deals with one of the measures above.

Background
A number of financial product and services providers collapsed in the wake of the Global Financial Crisis. These collapses left many investors, particularly those who had borrowed to invest, with great challenges in repaying their debts, meeting living expenses and, in some cases, keeping their homes. In the past 10 years, over 80,000 consumers have been affected, with losses totalling more than $5 billion, or $4 billion after compensation and liquidator recoveries.2

Ripoll Report
In response to the corporate collapses, the Parliamentary Joint Committee on Corporations and Financial Services (Joint Committee) conducted an inquiry into financial products and services in Australia.3 The final report, known as the Ripoll Report (after the Chair of the inquiry, Bernie Ripoll MP) was released in November 2009 and identified conflicted remuneration as the leading cause of poor financial advice provided to clients.

Payment of ongoing fees
Financial advisers are traditionally remunerated differently from other occupations. For example, many advisers have traditionally received commissions from product providers for placing clients with particular products, sometimes paid as a percentage of funds under management. Some commissions are ongoing in nature, forming what are known as ‘trail’ commissions.

In situations where the client pays a substantial proportion of the adviser’s remuneration directly (known as ‘fee for service’) it is common for this remuneration to be ongoing in nature. For example, an adviser might charge a client an ongoing annual fee calculated as a percentage of the client’s funds under management (known as an asset-based fee) or a flat dollar amount. This annual fee generally covers a range of advisory services provided to (or available to) clients.

As opposed to professions or other occupations that tend to charge for transactional, one-off services or advice, advisers’ remuneration structure is partly reflective of the notion that the benefits of financial advice tend to be realised over the medium to long-term, and therefore remuneration structures tend to reflect the ongoing nature of the adviser-client relationship.

1. For instance Storm Financial and Opes Prime: see Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, 23 November 2009; See also N Prior, ‘ASIC to take legal action on $300m Westpoint collapse’, The West Australian, 9 November 2007, p. 45; and G Wilkins, ‘Banksia signed off on “bad loan book” before merger’, The Sydney Morning Herald, 22 November 2014, p. 2.

2. Treasury, Key reforms in the regulation of financial advice, Background paper 8, prepared for the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, [13 April 2018], p. 5.

3. The terms of reference, submissions to the Parliamentary Joint Committee on Corporations and Financial Services and the final report of the Committee are available on the inquiry homepage.
The Ripoll Report identified significant structural tensions in the finance industry that give rise to conflicts of interest and affect the advice consumers receive:

On one hand, clients seek out financial advisers to obtain professional guidance on the investment decisions that will serve their interests, particularly with a view to maximising retirement income. On the other hand, financial advisers act as a critical distribution channel for financial product manufacturers, often through vertically integrated business models or the payment of commissions and other remuneration-based incentives.  

The Ripoll Report noted the different ways in which advisers can be remunerated directly or indirectly by product manufacturers for their clients' financial decisions concluding:

These payments place financial advisers in the role of both broker and expert adviser, with the potentially competing objectives of maximising [their own] remuneration via product sales and providing professional, strategic financial advice that serves clients' interests.  

Some submitters to the Joint Committee suggested that the quality of financial advice for consumers would be improved if commissions and other conflicted remunerative practices were banned.  

The Ripoll Report made 11 recommendations that were designed to enhance professionalism in the financial advice sector and enhance consumer confidence and protection. It stopped short of recommending an immediate ban on conflicted remuneration—recommending instead that 'government consult with and support industry in developing the most appropriate mechanism by which to cease payments from product manufacturers to financial advisers'.  

**Future of financial advice reforms**

On 26 April 2010, the Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen, announced the Future of Financial Advice (FOFA) reforms.  

The FOFA reforms were a package of amendments to the Corporations Act to change how financial advice is delivered to clients. The FOFA reforms were concerned with the way that financial advisers behave when giving advice, including how clients are charged and how fees are disclosed. According to Treasury:

The FOFA reforms were developed to address the recommendations of the Ripoll Report. They were aimed at improving the quality of financial advice provided to retail consumers of financial services through reducing conflicts of interests by better aligning the interests of the financial advisers and consumers. As well as applying to financial advisers, they apply to all Australian Financial Service licensees, representatives who give financial product advice to retail clients (including front-line bank staff, call centre staff and robo-advice providers).  

---

4. Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia, op. cit., pp. 69–70.  
5. Ibid., p. 75.  
7. Ibid., Chapter 7: Conclusions: Recommendations for reform, pp. 149–151.  
8. Ibid., recommendation 4, p. 151.  
10. Treasury, Key reforms in the regulation of financial advice, op. cit.
The Assistant Treasurer and Minister for Financial Services and Superannuation, Bill Shorten, circulated draft legislation relating to the proposed FOFA reforms on 28 August 2011.11

**FOFA 1 Bill**

The original form of the Corporations Amendment (Future of Financial Advice) Bill 2011 (FOFA 1 Bill) proposed to amend the Corporations Act to:

- require a fee disclosure statement (FDS) to be provided by a financial adviser to a client when charging advice fees for more than 12 months
- require a FDS and renewal notice to be provided by a financial planner to a client when charging advice fees for more than 24 months—known as opt-in—an adviser who has an ongoing fee arrangement with their client must get their client to renew the arrangement every two years. If the client does not opt-in, the arrangement will terminate
- extend ASIC’s licensing and banning powers.

The proposed amendments were to operate from 1 July 2012.

**FOFA 2 Bill**

The original form of the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (FOFA 2 Bill) proposed to amend the Corporations Act to:

- require those persons who are providing personal financial advice to retail clients to act in the best interests of their clients, and to give priority to their clients’ interests (see discussion below)
- impose a ban on conflicted remuneration (see discussion below)
- ban volume-based shelf-space fees from asset managers or product issuers to platform operators and
- ban asset-based fees on borrowed amounts.12

The proposed amendments were to operate from 1 July 2012.

**About conflicted remuneration**

The FOFA 2 Bill inserted section 963A into the Corporations Act. It defines conflicted remuneration as 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.

The FOFA 2 Bill proposed to ban the receipt of conflicted remuneration and its payment in certain circumstances. The ban relates to the receipt by licensees13 and their representatives.14 It includes

---

13. *Corporations Act*, section 963E.
14. *Corporations Act*, section 963G.
a ban on both monetary and non-monetary (soft-dollar) benefits. In addition, the FOFA 2 Bill detailed certain monetary and non-monetary benefits which would not be conflicted remuneration.\textsuperscript{15}

The proposed amendments were to operate from 1 July 2012.

\textbf{Report of the Parliamentary Joint Committee}

The FOFA 1 Bill was introduced into Parliament on 13 October 2011. On the same day, the House of Representatives referred the FOFA 1 Bill to the Parliamentary Joint Committee on Corporations and Financial Services (Parliamentary Joint Committee) for inquiry and report.

The FOFA 2 Bill was introduced into the Parliament on 24 November 2011. The House of Representatives immediately referred the FOFA 2 Bill to the same Committee.\textsuperscript{16}

The Parliamentary Joint Committee reported on the FOFA reforms on 29 February 2012.\textsuperscript{17} The majority made 15 recommendations and agreed that the FOFA provisions should generally commence on 1 July 2012.

The report included dissenting comments by the Coalition members of the Committee who concluded that the reforms in the FOFA 1 and FOFA 2 Bills would ‘lead to increased costs and reduced choice for Australians seeking financial advice’.\textsuperscript{18} The Coalition members of the Committee made 16 recommendations. These included, but were not limited to:

- the removal of the \textit{opt-in} arrangements\textsuperscript{19}
- the requirement to provide fee disclosure statements should be prospective and should not apply retrospectively to existing clients\textsuperscript{20}
- changes to the best interests duty\textsuperscript{21}
- refinement of the ban on receiving conflicted remuneration\textsuperscript{22}
- a start day of 1 July 2013 and a 12 month transition period.\textsuperscript{23}

\textbf{FOFA Bills as enacted}

\textbf{FOFA 1}

When the \textit{Corporations Amendment (Future of Financial Advice) Act 2012} was enacted the application and transitional provisions operated so that the law would apply only to new clients from 1 July 2012.\textsuperscript{24}

\begin{thebibliography}{24}
\bibitem{15} Corporations Act, sections 963B–963D.
\bibitem{16} The terms of reference for the inquiry, submissions to the Parliamentary Joint Committee on Corporations and Financial Services and the Committee’s final report are available on the \url{inquiry homepage}.
\bibitem{19} Ibid., recommendation 3, p. 163.
\bibitem{20} Ibid., recommendation 4, p. 166.
\bibitem{21} Ibid., recommendations 6 and 7, pp. 168, 170.
\bibitem{22} Ibid., recommendations 10 and 11, pp. 176, 179.
\bibitem{23} Ibid., recommendation 2, p. 160.
\bibitem{24} \textit{Replacement Explanatory Memorandum}, Corporations Amendment (Future of Financial Advice) Bill 2011, p. 16.
\end{thebibliography}
FOFA 2

Although the *Corporations Amendment (Further Future of Financial Advice) Act 2012* specifies a commencement date of 1 July 2012, the government subsequently announced that the FOFA reforms in both of the FOFA Acts would commence from 1 July 2012 with the provisions being voluntary until 1 July 2013, after which the legislation’s application would be mandatory.25 Government amendments during the passage of the legislation put those arrangements into effect.26

**Transitional provisions**

*FOFA 2* contained transitional provisions. Specifically, section 1528 of the *Corporations Act* relates to the application of the ban on conflicted remuneration. The section operates so that the conflicted remuneration provisions do not apply to a benefit given to the holder of an AFSL or their representative if the benefit was given under an arrangement that was entered into before 1 July 2013. These benefits are considered to be grandfathered.

There were some concerns expressed about how the grandfathering would operate if, for example, a financial adviser was to sell his or her business. In particular there was concern that such a sale would have the effect of altering the pre-1 July 2013 arrangement to such an extent that it would be a new arrangement and thereby be captured by the *FOFA 2* provisions.

**Coalition election commitment**

In the lead up to the 2013 Federal election, consistent with the views expressed in the dissenting comments in the Parliamentary Joint Committee report, the Coalition made a commitment to reduce the regulatory burden and compliance costs on the financial services sector. In particular, it was stated that ‘[t]he Coalition will amend the [FOFA] legislation to reduce compliance costs for small business financial advisers and consumers who access financial advice’.27 A number of amendments were suggested. Relevant to the measures in this Bill was a commitment to refining the ban on commissions on risk insurance inside superannuation.28

**Abbott government amendments**

**Streamlining FOFA Bill 2014**

The *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014* (Streamlining FOFA Bill) was introduced into the House of Representatives on 19 March 2014—that is, after the date of commencement of the *FOFA 1* and *FOFA 2* reforms. The purpose of the Streamlining FOFA Bill (in its original form) was to roll back some of the FOFA reforms such as:

- remove the need for clients to renew their ongoing fee arrangement with their adviser every two years (the opt-in requirement)
- make the requirement for advisers to provide a fee disclosure statement applicable only to those clients who entered into their arrangement after 1 July 2013


28. Ibid.
• remove from the list of steps an advisor may take in order to satisfy the best interests obligation the requirement that advisers must generally act and provide advice in the best interests of their clients (the catch-all provision)

• facilitate the provision of advice limited to, say, a particular product or product range (known as scaled advice)—that is, personal advice that is limited in scope and

• provide an exemption from the ban on conflicted remuneration for general advice, but not personal advice, in certain circumstances.29

The Streamlining FOFA Bill also contained amendments to broaden the circumstances under which conflicted remuneration could continue to be paid. For instance, as long as a client maintained their interest in a financial product, the proposed amendment would allow advisers to move licensees and continue to access grandfathered benefits—thereby addressing the concerns expressed in relation to FOFA 2.

According to the Explanatory Memorandum to the Streamlining FOFA Bill (as introduced):

Most industry stakeholders argue that the current grandfathering provisions have reduced adviser movements in the industry and have effectively ‘frozen’ the market; few advisers are willing to move licensees at all due to the loss of grandfathered benefits. Whilst the amendment allows grandfathered benefits to continue for a longer period of time, it is anticipated that industry will transition to a fee-for-service model as advisers cannot receive conflicted remuneration on arrangements entered into with new clients, and existing clients are likely to be transferred into new products/arrangements over time.30

The Streamlining FOFA Bill was passed by the House of Representatives on 28 August 2014 and was introduced into the Senate on 1 September 2014. However, debate on the Bill by the Senate did not proceed for more than 12 months. The Bill was not finally passed by both Houses of the Parliament until 1 March 2016. The Streamlining FOFA Bill was enacted as the Corporations Amendment (Financial Advice Measures) Act 2016 (Financial Advice Measures Act).

Importantly, the Financial Advice Measures Act amended the Corporations Act to broaden and clarify provisions that deem that certain benefits were not conflicted remuneration.31

**Streamlining Regulations**

Following the election of the Abbott Government, then Assistant Treasurer Arthur Sinodinos gave a speech to the Association of Financial Advisers’ National Conference in which he stated that the Government intended to implement its FOFA reforms and announced its intention to pass most of the reforms through Regulations.32

Accordingly, the Government made a number of Regulations which would implement its election promises in relation to the FOFA reforms as an interim measure. The Regulations are set out in the table below.

---

### Table 1: FOFA Regulations

<table>
<thead>
<tr>
<th>Name</th>
<th>Subject matter</th>
<th>Date commenced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporations Amendment Regulation 2013 (No. 5)</td>
<td>Tightened grandfathering arrangements for the ban on conflicted remuneration</td>
<td>1 July 2013</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2013 (No. 4)</td>
<td>Provided exemptions from the ban on conflicted remuneration for additional stockbroking-related activities</td>
<td>18 June 2013</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2013 (No. 3)</td>
<td>Removed the existing accountants’ licensing exemption and implement the new ‘limited’ licensing regime.</td>
<td>1 July 2013 (Schedule 1) 1 July 2016 (Schedule 2) 1 July 2019 (Schedule 3)</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2013 (No. 2)</td>
<td>Provided several minor exemptions from the FOFA reforms.</td>
<td>1 July 2013</td>
</tr>
<tr>
<td>Corporations Amendment (Intra-fund Advice Fees) Regulation 2013</td>
<td>Exempted intra-fund advice fees from the adviser charging regime and clarified the operation of the product fee exemption</td>
<td>5 June 2013</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2012 (No. 10)</td>
<td>Clarified the operation of the reduced best interests duty and the exemptions from the ban on conflicted remuneration, broadened the basic banking exemption from the ban on conflicted remuneration and exempted from the ban certain stockbroking-related activities.</td>
<td>27 November 2012 (Schedule 1) 1 July 2013 (Schedule 2)</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2012 (No. 8)</td>
<td>Implemented the original grandfathering arrangements for the ban on conflicted remuneration relating to platform providers.</td>
<td>3 October 2012</td>
</tr>
<tr>
<td>Corporations Amendment Regulation 2012 (No. 4)</td>
<td>Provided additional detail for the fee disclosure requirements; exempted product fees from the adviser charging regime; provided further detail on exemptions from the ban on conflicted remuneration for non-monetary benefits and exempted time-sharing schemes from the ban.</td>
<td>13 July 2012</td>
</tr>
<tr>
<td>Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014</td>
<td>Provided a number of changes to implement the Government’s election commitment to improve the FOFA provisions, including: removal of opt-in, removal of the ‘catch-all’ provision in the best interests duty, facilitating scaled advice and allowing certain benefits in relation to general advice.</td>
<td>1 July 2014 (disallowed by the Senate on 19 November 2014)</td>
</tr>
<tr>
<td>Corporations Amendment (Revising Future of Financial)</td>
<td>Provided a number of amendments including: changes to grandfathering arrangements for conflicted remuneration;</td>
<td>16 December 2014</td>
</tr>
</tbody>
</table>
**Effect of the Financial Advice Measures Act**

The premise for the FOFA reforms was that conflicts of interests exist, must be recognised and should be regulated. The legislative response made by the FOFA reforms did not seek to eliminate the conflicts. Instead, the reforms sought to ameliorate the consequences of the conflicts.

The enactment of the *Financial Advice Measures Act* did not change the fundamental elements of the FOFA reforms. However, the *Financial Advice Measures Act* introduced exceptions to the ban on conflicted remuneration.

**Monetary benefit that is not conflicted remuneration**

Section 963B of the *Corporations Act* lists those monetary benefits given to an AFSL or representative of an AFSL who provides financial product advice to persons as retail clients which are not conflicted remuneration.

For example, paragraph 963B(1)(c) exempts a monetary benefit from the ban on conflicted remuneration if it is given in relation to the issue or sale of a financial product, and the individual receiving the benefit has not provided financial product advice to the client in relation to the product that is to be issued or sold—or advice on a class of financial products or which the product is one—in the previous 12 months.

**Other exceptions**

Section 963C of the *Corporations Act* lists the non-monetary benefits which are given to an AFSL or representative of an AFSL who provides financial product advice to persons as retail client which are not conflicted remuneration.

Other exceptions exist in relation to benefits for employees of ADIs.  

---

33. M Cormann (Acting Assistant Treasurer), *Agreement reached to reinstate broadly supported elements of FOFA reforms*, media release, 26 November 2014; In order to achieve this, the Government successfully moved a motion in the Senate to partially rescind the disallowance motion of the Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014 from 19 November 2014. The motion rescinded the disallowance motion to the extent necessary to permit certain provisions to be remade under an agreement with the Opposition.

34. *Corporations Act*, section 963D.
Importantly these are separate from, and in addition to, the grandfathering arrangements which operate so that the conflicted remuneration rules only apply to arrangements entered into on or after 1 July 2013.

**Comments by the Royal Commission**

The problems with the operation of the FOFA reforms are summarised in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission):

… the FoFA reforms required the financial advice industry to make a fundamental change to the way advisers were remunerated. Before the introduction of those reforms, a significant source of revenue for financial advisers was commissions on the products they recommended. As in the case of mortgage brokers, financial advisers commonly received a combination of upfront and trail commissions: upfront commissions when the product was sold, and trail commissions in subsequent years.

While the compromises made in the FoFA reforms allowed advisers to continue to receive many of those commissions – most notably, trail commissions on products purchased before 1 July 2013, and upfront and trail commissions on many life insurance products – the ban on conflicted remuneration played an important role in shifting the financial advice industry from a commission-based model to a fee-for-service model. ³⁵ [emphasis added]

**Grandfathered commissions**

The Royal Commission noted that certain arrangements made before the FOFA reforms came into force in July 2013 that would otherwise have fallen within the ban on conflicted remuneration were, and remain, excluded from the definition of conflicted remuneration. According to the Royal Commission:

… despite it being recognised that the grandfathered forms of remuneration are conflicted remuneration (because they could reasonably be expected to influence the choice of financial product recommended by a licensee or representative to retail clients, or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative), charging and receiving these exempted forms of remuneration has been permitted to continue. ³⁶ [emphasis added]

And further:

At the time the grandfathering arrangements were first introduced, participants in the industry could say that sudden change in remuneration arrangements may bring untoward consequences for countervailing benefits that would not outweigh the harms of disruption … Even if the arguments relied on to justify the grandfathering exception were valid when that exception was introduced, it is now clear that they have outlived their validity. ³⁷

Accordingly, the Royal Commission recommended that the grandfathering provisions be removed as soon as possible. ³⁸

---


³⁶. Ibid., p. 182.

³⁷. Ibid., p. 185.

³⁸. Ibid.
The Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 was introduced into the House of Representatives on 1 August 2019 in response to that recommendation.

Committee consideration

Senate Standing Committee for the Selection of Bills

At its meeting of 1 August 2019, the Senate Standing Committee for the Selection of Bills recommended that the Bill not be referred to Committee for inquiry and report.\(^{39}\)

Senate Standing Committee for the Scrutiny of Bills

At the time of writing this Bills Digest, the Senate Standing Committee for the Scrutiny of Bills had not commented on the Bill.

Policy position of non-government parties

Senator Rex Patrick noted that grandfathered trailing commissions—where customers pay an ongoing fee to advisers for years after the initial advice was given—were a central theme of the Royal Commission. He committed to introduce a Private Senator’s Bill ‘to finally put an end to grandfathered conflicted remuneration’ ... ‘if the banks fail to take action, and if the government fails to take action’.\(^{40}\)

On 19 February 2019 the Leader of the Opposition, Bill Shorten, gave notice in the House of Representatives of his intention to present a Bill being the Corporations Amendment (Banking Royal Commission Recommendations Implementation—Ending Grandfathered Commissions) Bill 2019:

... to amend the Corporations Act to give effect to recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry to end grandfathering of commissions in financial advice, and for related purposes.\(^{41}\)

Although the proposed Bill was not introduced, it is likely that Australian Labor Party members and Senators will support the removal of the grandfathering provisions as proposed in the Bill.

Position of major interest groups

The Australian Banking Association reportedly has thrown its support behind a grandfathering ban.\(^{42}\) In the final report of the Royal Commission, it was noted that ‘each of the major banks has already announced steps to reduce or eliminate payments of grandfathered commissions in their financial advice businesses’.\(^{43}\)

In addition, the Royal Commission acknowledged each of the four major banks had made statements to the effect that their financial planning businesses would no longer retain grandfathered commissions.\(^{44}\)

---

44. Ibid., pp. 183–184.
However, the Association of Independently Owned Financial Professionals strongly argues against the Bill on the grounds that the reforms are ‘not valid under the constitution and legal action would be lodged soon after the legislation received royal ascent’. (This is discussed under the heading ‘Application of the Constitution’ below.)

Financial implications
According to the Explanatory Memorandum, the Bill will have no financial impact.

Statement of Compatibility with Human Rights
As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible.

Parliamentary Joint Committee on Human Rights
At the time of writing this Bills Digest, the Parliamentary Joint Committee on Human Rights had not commented on the Bill.

Key issues and provisions

Schedule 1—Part 1

Ending grandfathering from 1 January 2021
The provisions in Part 1 of the Bill amend the transitional provisions which were inserted into the Corporations Act at the time of the FOFA reforms.

Currently subsection 1528(1) of the Corporations Act sets out the application of the ban on conflicted remuneration. Under that subsection, Division 4 of Part 7.7A (that is, the rules about conflicted remuneration) 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 and
- the benefit is not given by a platform operator.

Existing subsection 1528(4) of the Corporations Act defines the application day is 1 July 2013.

Item 1 of Part 1 of the Bill repeals subsection 1528(1) and inserts proposed subsections 1528(1) and (1A) into the Corporations Act. The amendment operates so that the conflicted remuneration rules will apply to those benefits which are currently grandfathered—that is they arise from an arrangement entered into before 1 July 2013. This will have effect from 1 January 2021.

Application of the Constitution
Currently subsection 1528(3) of the Corporations Act provides that Division 4 of Part 7.7A (that is, the rules about conflicted remuneration) does not apply to a benefit given to a financial services licensee, or a representative of a financial services licensee, to the extent that it would result in an

46. Explanatory Memorandum, Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019, p. 3.
47. The Statement of Compatibility with Human Rights can be found at page 11 of the Explanatory Memorandum to the Bill.
acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms.

**Item 2** of Part 1 of the Bill repeals and replaces subsection 1528(3) to provide that section 1350 of the Corporations Act does not apply in relation to the operation of Division 4 of Part 7.7A.

Under section 1350 a person who acquires the property is liable to pay compensation of a reasonable amount to the person from whom the property is acquired if:

- the operation of the Corporations Act would result in the acquisition of property otherwise than on just terms and
- the acquisition would be invalid because of paragraph 51(xxxi) of the Constitution.

The Royal Commission dismissed claims that changing the permitted forms of remuneration would lead to constitutional difficulties because it would amount to an acquisition of property otherwise than on just terms. It made the following points in relation to such an assertion:

- First, where would be the acquisition? Who would acquire anything? What proprietary benefit or interest would accrue to any person?
- Second, if the point is good, it was good at the time when most forms of conflicted remuneration were prohibited. Yet no-one sought then to challenge the validity of the relevant provisions and the FOFA ban on conflicted remuneration has now operated for more than five years without challenge.  

**Volume-based shelf-space fees**

A platform operator is a financial services licensee that offers to be the provider of a custodial arrangement. The term custodial arrangement is defined in the existing section 1012IA of the Corporations Act as an arrangement where the client may instruct the platform to acquire certain financial products, and the products are then either held on trust for the client, or the client retains some interest in the product. A platform operator must not accept a volume-based shelf-space fee—that is, a fee which is wholly or partly dependent on the number or value of a funds manager’s financial products to which the custodial arrangement relates.

Currently subsection 1529(1) of the Corporations Act applies to grandfather the benefits to a financial services licensee of volume-based shelf-space fees in equivalent terms to the grandfathering of conflicted remuneration in section 1528 of the Corporations Act as discussed above. Items 3 and 4 of Part 1 of the Bill amend section 1529 so that the ban on volume-based shelf-space fees will apply where they arise from an arrangement entered into before 1 July 2013. This will have effect from 1 January 2021.

**Asset-based fees**

Section 964F of the Corporations Act provides that a fee for providing financial product advice to a person as a retail client is an asset-based fee to the extent that it is dependent upon the amount of funds used or to be used to acquire financial products by or on behalf of the person. Section 1531 of the Corporations Act provides that the conflicted remuneration rules apply to asset-based fees only if they are charged on or after 1 July 2013 on borrowed amounts, provided that those amounts are used or to be used to acquire financial products on or after that day.

49. Corporations Act, subsection 1526(1).
50. Corporations Act, subsection 964A.
Item 7 of Part 1 of the Bill repeals subsection 1531(2) of the Corporations Act and inserts proposed subsections 1531(1A) and (2) so that the grandfathering of asset-based fees is removed with effect from 1 January 2021.

**Schedule 1—Part 2**

Rebate of conflicted remuneration

Item 9 of Part 2 of the Bill inserts proposed Subdivision D—Rebate of conflicted remuneration into Part 7.7A of the Corporations Act so that Regulations may provide for a scheme under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected customers.

**Who is covered?**

Within new Subdivision D, proposed section 963M of the Corporations Act covers the following persons:

- a person who is legally obliged to give, on or after 1 January 2021, the conflicted remuneration to another person and
- a person who is prohibited from accepting the conflicted remuneration.

Proposed subsection 963M(3) provides, for the absence of doubt, that the section does not cover a person in relation to conflicted remuneration if Regulations made for the purpose of the subsection specify certain conditions in relation to conflicted remuneration and those conditions are met.

**Application of Regulations**

Proposed section 963N of the Corporations Act sets out a broad Regulation-making power to provide for a scheme under which a person covered by proposed section 963M must pay certain amounts based on the conflicted remuneration, or provide monetary benefits based on that conflicted remuneration.

Under proposed subsection 963N(2) this will be required in the following circumstances:

- a financial services licensee, or a representative of a financial services licensee provided (or was legally obliged to provide) financial product advice to one or more persons as retail clients, in connection with the conflicted remuneration and
- the financial product advice relates to a particular financial product or class of financial products.

Proposed subsection 963N(4) further provides that the Regulations may make different provision in respect of any of the following:

- different classes of person covered by section 963M
- different classes of financial product
- different classes of product holder
- different classes of conflicted remuneration and
- different classes of circumstances in which conflicted remuneration arises.

Under proposed subsection 963N(6) the Regulations may also provide for any of the following matters:

- the identification of product holders
Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019

• the timeframe for making payments or providing monetary benefits
• a method or methods of determining amounts of payments, or amounts of monetary benefits and
• a method or methods of making payments or providing monetary benefits.

Proposed section 963P of the Corporations Act provides that a failure to pay moneys to a person covered by section 963M as required by the Regulations gives rise to a civil penalty.\(^{51}\)

Regulations exposure draft


The exposure draft amends the Corporations Regulations 2001 by inserting proposed Subdivision 4A—Ban on conflicted remuneration (rebates).

If the conflicted remuneration can be attributed to a single client then proposed subsection 7.7A.15AL(2) of the Corporations Regulation requires a covered person must provide a cash rebate to the affected retail client on a dollar-for-dollar basis within 10 business days.\(^{52}\)

Proposed section 7.7A.15AM sets out the requirements where conflicted remuneration relates to a group of clients—for instance because of the volume of products sold. In that case the amount paid, or the amount of the monetary benefit provided,\(^{53}\) to each of the clients must be an amount that is just and equitable in the circumstances.\(^{54}\) The following matters are to be taken into account in determining whether an amount is just and equitable:

• the amount of the conflicted remuneration
• the total amount invested by the clients in the financial products to which the conflicted remuneration relates
• the amount invested by each client expressed as a proportion of the total amount invested in the financial product to which the conflicted remuneration relates
• the structure of the fees (if any) that the clients have paid in respect of financial products to which the conflicted remuneration relates
• the extent to which the sum of the amounts to be paid, and the amount of the monetary benefits to be provided, to the clients equals the amount of the conflicted remuneration and
• any other relevant matter.\(^{55}\)

The exposure draft would also impose requirements on covered persons to keep records of how and when conflicted remuneration was rebated after 1 January 2021.

---

51. Corporations Act, subsection 1317E(3).
53. Ibid., p. 2. The monetary benefit may be by way of a reduction in fees.
54. Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019 (exposure draft), proposed regulation 7.7A.15AM(3).
The exposure draft contains application provisions which will operate to override existing grandfathering provisions contained in the Corporations Regulations with effect from 1 January 2021.

Concluding comments

The FOFA reforms were first recommended in 2009. Now, in the light of scathing comments by the Royal Commission, they are to apply to financial arrangements entered into prior to 1 July 2013. The end to grandfathering and the enactment of the rebate scheme in the Regulations will remove existing incentives to maintain clients in unsuitable financial products.

What remains though, are the exceptions to the general rules about what constitutes conflicted remuneration, which are not altered by the Bill.