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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TREASURY LAWS AMENDMENT (ENDING GRANDFATHERED CONFLICTED
REMUNERATION) BILL 2019

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Josh Frydenberg MP)

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Glossary

The following abbreviations and acronyms are used throughout this Explanatory Memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Act	<i>Corporations Act 2001</i>
Bill	Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

General outline and financial impact

Conflicted remuneration

This Bill amends the Act to end the grandfathering regime that currently applies in relation to the conflicted remuneration provisions of the Act.

Date of effect: 1 January 2021

Proposal announced: This measure was announced in the Government's response to the Royal Commission on 4 February 2019 (Recommendation 2.4).

Financial impact: Nil.

Human rights implications: This bill does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 2, paragraphs 2.1 to 2.6.

Compliance cost impact: It is estimated that the increase in annual compliance costs for the industry as a whole will amount to \$9 million.

The Treasury has undertaken a process equivalent to a Regulation Impact Statement through the Royal Commission. The link to the Royal Commission Final Report can be found here:

<https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;adv=yes;orderBy=date-eFirst;page=1;query=%22Royal%20Commission%22%20Date%3A01%2F02%2F2019%20%3E%3E%2028%2F02%2F2019%20Dataset%3Atabledpapers;rec=9;resCount=Default>

Chapter 1

Conflicted remuneration

Outline of chapter

1.1 The Bill implements the Government's response to Recommendation 2.4 of the Final Report of the Royal Commission. The Royal Commission recommended that the grandfathering arrangements for conflicted remuneration in relation to financial advice provided to retail clients should be removed as soon as is reasonably practicable.

1.2 The Bill removes these grandfathering arrangements for conflicted remuneration and other banned remuneration from 1 January 2021. The Bill also enables the regulations to provide for a scheme under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected customers.

Context of amendments

1.3 The Act includes provisions that ban conflicted remuneration and certain other remuneration in relation to financial advice provided to retail clients. These provisions aim to more closely align the interests of those who provide financial product advice with the interests of their retail clients. In particular:

- Division 4 of Part 7.7A of the Act bans the payment and receipt of benefits which have the potential to influence financial advice provided to retail clients about financial products;
- Division 5 of Part 7.7A of the Act bans platform operators from accepting volume-based shelf-space fees; and
- Division 5 of Part 7.7A of the Act bans financial services licensees and authorised representatives of financial services licensees from charging asset-based fees to retail clients in relation to borrowed amounts.

1.4 These Divisions generally apply to benefits given or, with respect to asset-based fees on borrowed amounts, fees charged from

1 July 2013.¹ However, there are currently exemptions to these Divisions for ‘grandfathered arrangements’. Under the grandfathering provisions:

- the bans on accepting and giving conflicted remuneration do not apply to benefits paid under arrangements entered into before 1 July 2013 except with respect to benefits given by a platform operator (see section 1528 of the Act);
- the ban on charging volume-based shelf space fees does not apply to benefits given under arrangements entered into before 1 July 2013 (see section 1529 of the Act); and
- the ban on charging asset-based fees to retail clients on borrowed amounts only applies to the extent that the borrowed amounts are used or are to be used to acquire financial products on or after 1 July 2013 (see section 1531 of the Act).

1.5 On 1 February 2019, the Final Report of the Royal Commission recommended that grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practicable (Recommendation 2.4).

1.6 On 4 February 2019, in its response to the Royal Commission, the Government announced that it would end the grandfathering of conflicted remuneration to financial advisers effective from 1 January 2021 and mandate that previously grandfathered conflicted remuneration be rebated to customers.

1.7 On 22 February 2019, the Government released an exposure draft bill with this effect for public consultation. The draft bill also provided for regulations to be made to provide for the pass through to customers of the benefits of any previously grandfathered conflicted remuneration remaining in contracts after 1 January 2021. Submissions were received from a number of stakeholders including industry bodies and consumer groups.

1.8 On 28 March 2019, the Government released exposure draft regulations for public consultation. These draft regulations also provided details on how benefits must be rebated to customers and details of record keeping obligations on persons required to pass through benefits. The draft regulations also repealed a number of other grandfathering

¹ The Act made provision for persons to elect to comply with the obligations in Division 4 and Division 5 of Part 7.7A from a date earlier than 1 July 2013 (a date between 1 July 2012 and 1 July 2013). Under the Act, these elections may have the effect that the grandfathering provisions apply with reference to that earlier date. For readability, this memorandum refers to 1 July 2013 as the date in relation to which the grandfathering provisions operate.

arrangements which are contained in Part 7.7A of the *Corporations Regulations 2001*.

Summary of new law

1.9 The Bill removes grandfathering arrangements for conflicted remuneration and other banned remuneration effective from 1 January 2021. This means that from 1 January 2021 all remuneration of a kind banned by Divisions 4 or 5 of Part 7.7A of the Act will be subject to the bans in those Divisions.

1.10 As part of ending grandfathering, the Government will also make regulations prior to 1 January 2021 that will repeal a number of other grandfathering arrangements which are contained in Part 7.7A of the *Corporations Regulations 2001*.

1.11 The Bill also enables regulations to provide for a scheme under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected customers.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Grandfathering arrangements for conflicted remuneration and other banned remuneration in relation to financial advice to retail clients are removed, effective from 1 January 2021.	Conflicted remuneration and other banned remuneration may be paid if the benefit is paid under a grandfathered arrangement entered into before the application day specified in the Act (generally 1 July 2013).
Regulations may provide for a scheme under which amounts that would otherwise have been paid as conflicted remuneration are rebated to affected customers.	No equivalent.

Detailed explanation of the new law

1.12 The Bill ends the grandfathering of arrangements for conflicted remuneration and other banned remuneration in relation to financial advice, effective from 1 January 2021. This means that from 1 January 2021 all remuneration of a kind banned by Divisions 4 or 5 of Part 7.7A of the Act will be subject to the bans in those Divisions.

1.13 As part of ending grandfathering, the Government will also make regulations prior to 1 January 2021 that will repeal a number of other grandfathering arrangements which are contained in Part 7.7A of the *Corporations Regulations 2001*.

Removing grandfathering arrangements

1.14 The new law removes the grandfathering of conflicted remuneration under Division 4 of Part 7.7A, effective from 1 January 2021. [*Schedule 1, item 1, subsections 1528(1) and (1A) of the Act*]

1.15 The new law repeals existing subsection 1528(3) of the Act. Subsection 1528(3) of the Act currently provides that Division 4 of Part 7.7A does not apply to a benefit to the extent that the operation of the Division would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Constitution). [*Schedule 1, item 2, subsection 1528(3) of the Act*]

1.16 The new law provides that section 1350 of the Act does not apply in relation to the operation of Division 4 of Part 7.7A in respect of a benefit given to a financial services licensee, or a representative of a financial services licensee. Section 1350 of the Act provides for compensation to be payable where the operation of the Act would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Constitution). [*Schedule 1, item 2, subsection 1528(3) of the Act*].

1.17 The new law removes the grandfathering of volume-based shelf-space fees, effective from 1 January 2021. [*Schedule 1, item 3, subsections 1529(1) and (1A) of the Act*]

1.18 The new law provides that section 1350 of the Act does not apply in relation to the operation of Subdivision A of Division 5 of Part 7.7A of the Act in respect of a benefit given to a financial services licensee, or an RSE licensee. [*Schedule 1, item 4, subsection 1529(2A) of the Act*]

1.19 The new law repeals existing section 1530 of the Act. Section 1530 currently provides that regulations made for the purposes of subsections 1528(2) or 1529(2) of the Act do not apply to a benefit to the extent that the operation of the Division would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Constitution). [*Schedule 1, item 5, section 1530 of the Act*]

1.20 The new law provides that section 1350 does not apply in relation to regulations made for the purposes of subsection 1528(2) or 1529(2) of the Act. [*Schedule 1, item 5, section 1530 of the Act*]

1.21 The new law removes the grandfathering of asset-based fees charged to retail clients on borrowed amounts, effective from 1 January 2021. *[Schedule 1, items 6 and 7, subsections 1531(1) and (1A) of the Act]*

1.22 The new law also repeals existing subsection 1531(2) of the Act. Subsection 1531(2) of the Act currently provides that Subdivision B of Division 5 of Part 7.7A does not apply to a benefit to the extent that the operation of the Division would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Constitution). *[Schedule 1, item 7, subsection 1531(2) of the Act]*

1.23 The new law also provides that section 1350 of the Act does not apply in relation to the operation of Subdivision B of Division 5 of Part 7.7A in respect of an asset-based fee. *[Schedule 1, item 7, subsection 1531(2) of the Act]*

Rebating provisions for conflicted remuneration

1.24 The new law allows for the regulations to provide for a scheme under which benefits that would otherwise have been paid as conflicted remuneration after 1 January 2021, but for the Bill, are rebated.

1.25 Under a scheme made in the regulations, the obligation to rebate would apply to a person who is legally obliged (disregarding the ban on conflicted remuneration in Subdivision C of Division 4 of Part 7.7A of the Act) to give conflicted remuneration to another person, on or after 1 January 2021. The regulations may exclude people from this obligation or extend the obligation to more people. *[Schedule 1, item 9, section 963M and subsection 963N(1) of the Act]*

1.26 A scheme under the regulations would provide for rebates to product holders. Product holders is defined to include retail clients who received, or were legally entitled to receive, financial product advice in connection with the conflicted remuneration.

1.27 The definition of product holder also includes people who hold the same financial products (or products in the same class) as those in relation to which the conflicted financial product advice was provided. *[Schedule 1, item 9, subsections 963N(2) and (3) of the Act]*

1.28 In circumstances where a financial product is held by a person on behalf of another person, both people are product holders for the purposes of the Bill. This is to ensure that the rebating scheme in the regulations can facilitate the provision of the rebate to the ultimate holder of the product. *[Schedule 1, item 9, subsection 963N(3) of the Act]*

1.29 The amounts that are required to be rebated under the scheme are to be based on the conflicted remuneration that would have been payable but for the ban introduced under the Bill. The scheme may

provide for rebating to occur by means of making a payment or providing a monetary benefit (for example, reducing a fee). *[Schedule 1, item 9, section 963N of the Act]*

1.30 This regulation making power is intended to be a broad power to ensure that the rebating scheme can be effective for the variety of situations in which conflicted remuneration is provided. To this end, the new law provides that:

- the regulations may make different provision in respect of: different classes of persons that would otherwise have given conflicted remuneration; 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; and
- the regulations may provide for: the identification of product holders; the timeframe in which rebates must occur; 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.

1.31 These provisions are a non-exhaustive list of the matters that may be dealt with by the regulations. Their inclusion in the new law is not intended to limit the matters that may properly be dealt with by the regulations. *[Schedule 1, item 9, subsections 963N(4) and 963N(6) of the Act]*

1.32 In light of the broad definition of product holder, the new law also provides that the regulations may provide that payments or monetary benefits need not be provided to one or more specified classes of product holder. *[Schedule 1, item 9, subsection 963N(5) of the Act]*

1.33 The new law also provides for civil penalties if a person fails to pay an amount or monetary benefit in accordance with the regulations. New section 963P is a Part 7.7A civil penalty provision. *[Schedule 1, items 8 to 10, sections 9 and 963P and subsection 1317E(3) of the Act]*

Commencement

1.34 The new law commences on 1 January 2021. *[Section 2 of the Bill]*

Chapter 2 Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019

2.1 The Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.2 The Bill implements a recommendation of the Final Report of the Royal Commission that grandfathering provisions for conflicted remuneration should be removed as soon as is reasonably practicable.

2.3 It provides for the removal of grandfathering arrangements for conflicted remuneration for financial advice, volume-based shelf-space fees and asset-based fees on borrowed amounts, effective from 1 January 2021.

2.4 It also provides for a scheme, to be made by regulations, under which benefits amounting to conflicted remuneration that would otherwise continue to be given after 1 January 2021 are rebated to affected customers.

Human rights implications

2.5 The Bill does not engage any of the applicable rights and freedoms.

Conclusion

2.6 The Bill is compatible with human rights.