EXPLANATORY STATEMENT

Select Legislative Instrument 2013 No. 151

Issued by authority of the Minister for Financial Services and Superannuation

Corporations Act 2001

Corporations Regulations 2001

Corporations Amendment Regulation 2013 (No. 5)

The *Corporations Act 2001* (the Act) provides for the regulation of corporations, financial markets, and products and services, including in relation to licensing, conduct, financial product advice and disclosure.

Subsection 1364(1) of the Act provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The *Corporations Amendment Regulation 2013 (No. 5)* (the Regulation) amends the *Corporations Regulations 2001*. The amendment is in respect of the provisions in Parts 7.7A and 10.18 of the Act, dealing with the ban on conflicted remuneration.

Specifically, the Regulation outlines the application of the ban on conflicted remuneration as follows:

- for benefits paid by platform operators, the ban will apply in relation to new clients from 1 July 2014; and for non-platform providers, the ban will apply in relation to new clients and investments in new products by existing clients from 1 July 2014;

- for benefits paid to employees under an enterprise agreement in force immediately prior to 1 July 2013, the ban will apply from six months after the nominal expiry date (NED) of the agreement (or 1 July 2014 for those agreements which passed their NED before 1 July 2013); and

- for benefits paid to employees under non-enterprise agreements, the ban will apply from 1 July 2014.

In addition, the Regulation excludes the following benefits from the ban on conflicted remuneration:

- benefits made in relation to the purchase or sale of a financial advice business and the payment of these benefits to third parties on or after the commencement of the ban that result from an arrangement entered into before 1 July 2013; and

- grandfathered benefits that are passed onto other parties that were not subject to the agreement which gave rise to the grandfathered benefit (but which the passed-on benefit is given under a pre-application day arrangement), for example, an authorised representative or a financial adviser who is an employee of a licensee or authorised representative.

A draft of the Regulation was published on the Future of Financial Advice website on 4 March 2013 for a two-week consultation period. A total of 10 formal submissions were received from stakeholders in the financial services sector, including Ababus Australian Mutuals, the Association of Financial Advisers, the Australian Bankers' Association, Australian Financial Markets Association, the Financial Services Council and the Industry Super Network.

Most issues raised in the submissions were of a technical nature, with some submissions proposing additional products that require separate treatment to ensure grandfathering is preserved on equal standing to other products. For example, managed investment schemes and multi-product offerings. Separate provision for these products has been included in the Regulation.

Details of the Regulation are set out in Attachment A. A statement of the Regulation's compatibility with human rights is set out in Attachment B.

The Regulation is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*. The Act does not specify any conditions that need to be satisfied before the power to make the Regulation may be exercised.

The Regulation commences on 1 July 2013.

ATTACHMENT A

Details of the Corporations Amendment Regulation 2013 (No. 5)

Section 1 – Name of Regulation

This section specifies the name of the Regulation as the *Corporations Amendment Regulation 2013 (No. 5)*.

Section 2 – Commencement

This section specifies that the Regulation commences on 1 July 2013.

Section 3 – Authority

This section provides that the authority for making the Regulation is the *Corporations Act 2001* (the Act).

Section 4 – Schedule(s)

This section provides that Schedule 1 amends the *Corporations Regulations 2001*.

Schedule 1 – Amendments

Item 1 inserts a new regulation 7.7A.12EA to specify a type of monetary benefit that is not conflicted remuneration for the purposes of paragraph 963B(1)(e) of the Act. The regulation covers what are commonly referred to in the financial advice industry as 'buyer of last resort' arrangements. These arrangements allow the purchase or sale of all or part of a licensee's or representative's financial advice business using a specified formula. The term 'financial advice business' is intended to have its ordinary meaning. It is noted that a financial advice business may include the provision of some other financial services to clients.

The regulation deems that the price for the business is not conflicted remuneration to the extent it is based, in whole or in part, on the number or value of financial products held by the licensee's or representative's clients and the weighting attributed to the financial products that are issued by the licensee, a related body corporate or other person is the same as the weighting attributed to other similar financial products. In these situations, buyer of last resort arrangements alone would not influence the advice to recommend products issued by the licensee or a related party.

Item 2 replaces the current regulation 7.7A.16 'Application of ban on conflicted remuneration' with a new regulation 7.7A.16 'Application of ban on conflicted remuneration – platform operator (Division 4 of Part 7.7A of Chapter 7 of the Act does not apply)'.

Regulation 7.7A.16 is made for the purposes of subsection 1528(2) of the Act and prescribes circumstances in which the ban on conflicted remuneration in Division 4 of Part 7.7A of the Act does not apply to a benefit given by a platform operator. That is, regulation 7.7A.16 provides for the 'grandfathering' of these payments. Consistent with the grandfathering arrangements for non-platform operators contained in subsection 1528(1) of the Act, this regulation provides for the grandfathering of any benefit given under an arrangement entered into before the application date.

The term 'platform operator' is defined in section 1526 of the Act. Broadly, a platform operator is a financial services licensee or 'RSE licensee' (as defined in the

Superannuation Industry (Supervision) Act 1993) that offers to be the provider of a custodial arrangement. A 'custodial arrangement' is 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. It is noted that in some limited circumstances a platform operator may also hold assets of a client in a non-custodial capacity.

The 'application day' is defined in subsection 1528(4) of the Act as the earlier of 1 July 2013 or the day specified in a notice lodged with ASIC indicating that the obligations and prohibitions imposed under Part 7.7A of the Act are to apply to a person. This reflects the transitional arrangements for the Future of Financial Advice (FOFA) reforms, under which compliance becomes mandatory on 1 July 2013, but persons can formally elect to comply with the measures at an earlier date.

The regulation adds further detail to regulation 7.7A.16 to ensure that where a party to an arrangement changes, the arrangement is taken to have continued in effect for the purposes of grandfathering arrangements (subregulation 7.7A.16(3)). It may be that arrangements are amended from time to time for various reasons, such as where parties restructure for efficiency purposes or assign their rights under the arrangement to another party (which may result in a change to a party to the contract).

However, restructuring simply in order to continue or increase grandfathered payments may attract the operation of the relevant anti-avoidance provision of the Act (section 965). If the changes to an arrangement extend beyond a change to a party, the parties will need to give consideration to whether the changes are sufficiently material to trigger a new arrangement. Grandfathering will not be brought to an end where the application of the ban would bring about an acquisition of property otherwise than on just terms (see subsection 1528(3) of the Act).

A person subject to Division 4 of Part 7.7A of the Act will be a platform operator or not a platform operator. Taken together regulation 7.7A.16 and subsection 1528(1) of the Act create a consistent starting point for both platform and non-platform operators. However, in both cases it is possible for a benefit following from a pre-application date arrangement to remain subject to Division 4 if it falls within the scope of regulation 7.7A.16A or 7.7A.16B as discussed below.

If a benefit paid meets the conditions in regulations 7.7A.16, 7.7A.16A or 7.7A.16B, subregulation 7.7A.16(4) states that the reader is to disregard 7.7A.16 when determining whether the benefit is grandfathered. That is, the benefit would be subject to Division 4 of Part 7.7A because of regulations 7.7A.16A or 7.7A.16B and consequently would not be grandfathered by regulation 7.7A.16.

Regulation 7.7A.16A provides that a benefit will be subject to the ban on conflicted remuneration if that benefit is:

- given by a person acting in the capacity as a platform operator;
- given under an arrangement that was entered into before the application day; and
- the benefit:
  - relates to an acquisition (including a regulated acquisition) of a financial product on the instructions of a person who had not given an instruction to

the person acting in the capacity of the platform operator to open an account before 1 July 2014; or

– does not relate to a person who opened an account on the platform before 1 July 2014; and

- the benefit was not given under an employee remuneration arrangement to which regulation 7.7A.16C would apply.

Subparagraph 7.7A.16A(2)(c)(ii) is designed to ensure benefits paid by a platform operator that do not specifically relate to a person who opened an account on the platform before 1 July 2014 and otherwise would be conflicted remuneration are subject to Division 4 of Part 7.7A of the Act. An example of this may include a marketing or sponsorship payment from a platform operator to a licensee that is designed to incentivise the licensee to recommend the platform to its clients.

It is noted that it is possible for a platform operator not to be operating in the capacity as a platform operator. For example, the platform operator may also be the responsible entity of a managed investment scheme or the employer of staff. In order to fall within the scope of regulation 7.7A.16A, it is necessary for a person to not only be a platform operator, but also be acting in the capacity as a platform operator. If a person is not operating in the capacity as a platform operator, they will come within the scope of regulation 7.7A.16B or 16C. Subregulation 7.7A.16A(3) provides further clarity on when a benefit has been given by a person acting in the capacity as a platform operator as including activities that are undertaken in connection with the platform where a client has provided instructions to the platform operator, for example, setting up a cash management account that is linked to the client's account on the platform.

For the avoidance of doubt, if a retail client has an interest in the platform before 1 July 2014, subregulation 7.7A.16A(4) provides that a benefit relates to the acquisition of a financial product if it is paid in relation to the initial acquisition of the product or the subsequent holding of that product. That is, a benefit will be grandfathered for existing clients even if the benefit relates to the initial acquisition of a product or the subsequent holding of that product.

Subregulation 7.7A.16A(5) allows for changes to the parties to the arrangement without this event triggering a new arrangement for the purposes of the grandfathering provisions.

If a benefit paid meets the conditions in both regulations 7.7A.16 and 7.7A.16A, subregulation 7.7A.16A(6) states that the reader is to disregard 7.7A.16 when determining whether the benefit has been grandfathered. That is, the benefit would be subject to Division 4 of Part 7.7A because of regulation 7.7A.16A.

The arrangements referred to in regulation 7.7A.16A will predominately be arrangements between platform operators and financial services licensees that provide financial product advice to retail clients under which the platform operator agrees to provide a benefit to the licensee depending on the volume of the licensee's clients using the platform.

The effect of regulation 7.7A.16A is to grandfather benefits given under pre-application date arrangements except where they relate to a new client coming onto the platform from 1 July 2014. Arrangements between financial services

licensees and platform operators entered into from 1 July 2013 will not be grandfathered and must not include the provision of conflicted remuneration.

Regulation 7.7A.16B prescribes circumstances in which Division 4 of Part 7.7A of the Act applies to benefits given by persons not operating in the capacity as a platform operator where Division 4 would not otherwise apply by virtue of subsection 1528(1) of the Act. Regulation 7.7A.16B deliberately narrows the more generous grandfathering provided for in subsection 1528(1).

Regulation 7.7A.16B provides that a benefit will be subject to the ban on conflicted remuneration if that benefit is:

- given by a person not acting in the capacity as a platform operator;
- given under an arrangement entered into before the application day; and
- the benefit:
  - is given in relation to the acquisition of a financial product on or after 1 July 2014, which is for the benefit of a retail client; or
  - does not relate to a financial services provided to a retail client before 1 July 2014; and
- the client did not have an interest in the product before 1 July 2014; and
- the benefit was not given under an employee remuneration arrangement to which regulation 7.7A.16C would apply.

Subparagraph 7.7A.16B(2)(c)(ii) is designed to ensure benefits that do not necessarily relate to a financial service provided after 1 July 2014, and otherwise would be conflicted remuneration, are subject to the ban on conflicted remuneration. An example of this may include a marketing or sponsorship payment from a product issuer to a licensee that is designed to incentivise the licensee to recommend the issuer's products.

Subregulation 7.7A.16B(3) provides clarity on when a person is acting in the capacity as a platform operator, and as a result provides clarity on when a person is not acting in this capacity in order to assist in the interpretation of paragraph 7.7A.16B(2)(a).

Paragraph 7.7A.16B(4)(a) allows for changes to the parties to the arrangement without this event triggering a new arrangement for the purposes of the grandfathering provisions.

For the avoidance of doubt, if a retail client has an interest in a financial product before 1 July 2014, paragraph 7.7A.16B(4)(b) provides that a benefit is considered to be related to the acquisition of a financial product if it is paid in relation to the initial acquisition of the product or the subsequent holding of that product. That is, a benefit will be grandfathered for existing clients even if the benefit relates to the initial acquisition of a product or the subsequent holding of that product.

Subregulations 7.7A.16B(5) and (6) allows for a client to increase their interest in an existing managed investment scheme or multi-product offering without being taken to have acquired a new financial product. This means that non-platform operators can continue to pay conflicted remuneration in relation to clients who increase their

exposure to a scheme or multi-product offering that the client had an interest in before 1 July 2014.

In addition, if it is possible for the client to change the nature of their interest without resulting in the acquisition of a different underlying product, this will not cause grandfathering to cease. This may be the case, for example, where a client moves between investment options (that is, from the growth option to the balanced option) within a managed investment scheme or multi-product offering, or changing the limit on a pre-existing margin loan.

The arrangement referred to in 7.7A.16B is the arrangement that provides for the conflicted remuneration. For example, this may be an arrangement between a financial services licensee that provides financial product advice to retail clients and a fund manager or product issuer under which commissions are paid to the licensee based on the volume of the licensee's clients holding the fund manager's or product issuer's financial products. Regulation 7.7A.16B also applies to acquisitions of financial products through a platform where the benefit is not paid by a person acting in the capacity as a platform operator, for example the fund manager of a particular product offered by the platform.

The effect of regulation 7.7A.16B is to limit the grandfathering to conflicted remuneration paid under pre-application date arrangements relating to holdings of clients that had investments in a product, fund or scheme before 1 July 2014. Benefits given by a person not acting in the capacity of platform operator will be subject to Division 4 of Part 7.7A for investments in new financial products from 1 July 2014, regardless of whether these investments are made through a platform or directly by the client. If a benefit paid meets the conditions in regulations 7.7A.16 and 7.7A.16B, subregulation 7.7A.16B(7) states that the reader is to disregard 7.7A.16 when determining whether the benefit has been grandfathered.

Together, regulations 7.7A.16A and 7.7A.16B grandfather benefits given by platform operators and persons other than platform operators under a consistent approach. In both cases, benefits given in relation to new clients from 1 July 2014 are not grandfathered, even if the benefit is given under a pre-application day arrangement.

In relation to both platforms and non-platforms, grandfathering will not cease when a client makes additional contributions to an existing interest in a superannuation fund or a life insurance investment product, as a new acquisition will not have taken place (see subsection 761E(3A) of the Act) .

A client is taken to have acquired a new financial product if they move from the accumulation to the pension phase of a superannuation fund as a result of existing regulation 7.1.04E. If this move occurs after 1 July 2014, benefits relating to the pension phase will not be grandfathered and will be subject to Division 4 of Part 7.7A. However, grandfathering will not cease when a client moves to the pension phase where the relevant products are offered under a platform or a multi-product offering and the client had an interest in the platform or multi-product offering prior to 1 July 2014.

With regard to persons acting in the capacity of a platform operator, conflicted remuneration can continue to be paid in relation to new investments, or a switch in investments on that platform, only if the client had an interest held through the platform before 1 July 2014.

Persons not acting in the capacity as a platform operator are only able to pay conflicted remuneration in relation to new investments if the client is increasing their existing interest in a managed investment scheme, product or multi-product offering. If the client is investing in a completely different scheme, product or offering, no conflicted remuneration can be paid. However, increasing an interest or switching investment options within a scheme, superannuation product, life insurance investment product or multi-product offering will not cease grandfathering (as outlined above).

Regulation 7.7A.16C provides detail on when Division 4 of Part 7.7A of the Act will not apply to benefits given under a remuneration arrangement between an employer and employee. Separate arrangements are provided for benefits given under an enterprise agreement (or collective agreement-based transitional instrument) and benefits given under an agreement that is not a collective agreement.

Subregulation 7.7A.16C(2) provides that Division 4 will not apply if the benefit is given in accordance with terms under an enterprise agreement (or a collective agreement-based transitional instrument), including any associated documents, where the agreement was entered into before the application day. Subregulation 7.7A.16C(3) provides that Division 4 will apply to benefits given under the above agreements at the end of six months after the NED of the agreement. For agreements which have passed their NED before the application day, Division 4 will apply from 1 July 2014 (subregulation 7.7A.16C(4). The term 'nominal expiry date' is taken to have the same meaning as is in the *Fair Work Act 2009* (Fair Work Act).

Subregulation 7.7A.16C(5) provides that Division 4 will not apply where a benefit is paid under an agreement that is not an enterprise agreement (or a collective-based transitional instrument), and the benefit is payable in relation to a period that ends before 1 July 2014. Effectively, Division 4 will apply to benefits that relate to a period from 1 July 2014.

Subregulation 7.7A.16C(6) provides the definitions for 'collective agreement' and 'collective agreement-based transitional instrument'.

It is not the Government's intention for the application of Division 4 of Part 7.7A of the Act to terminate pre-application date arrangements to the extent that they provide for grandfathered conflicted remuneration. However, it is possible for the application of Division 4 to have this effect if that was the intention of the parties when the arrangement was entered into. Regulation 7.7A.16D provides for Division 4 not to apply to a post-application date arrangement where it is the same as a pre-application date arrangement that was terminated as a result of the application of Division 4. The post-application date arrangement must be the same as the pre-application date arrangement, except that the post-application arrangement does not provide for the payment of any remuneration that is not grandfathered.

Regulation 7.7A.16E provides that a change in a party to a pre-application date arrangement is a circumstance under which Division 4 of Part 7.7A of the Act will not apply. This is intended to apply the same approach to continuity of arrangements in relation to section 1528 that also exist in relation to the regulations described above (see subregulations 7.7A.16(3), 7.7A.16A(4) and 7.7A.16B(3)).

It is often the case that conflicted remuneration will be paid to a financial services licensee who will then pass some or all of the remuneration to the individual representative that actually provided the advice to the retail client. This payment can

often first go through another party (for example, a franchisee or an authorised representative of the licensee) before it is passed onto an individual representative. The individual representative (and other parties above) will not be a party to the arrangement under which the conflicted remuneration is paid to the licensee.

Regulation 7.7A.16F ensures that a licensee can pass on all or some of the grandfathered conflicted remuneration without being subject to the ban on conflicted remuneration (and any further pass-through of the benefit) as long as the benefit passed-on is given under a pre-application day arrangement. In addition, regulation 7.7A.16F identifies additional safeguards, including ensuring that the payments are passed-on in a manner consistent with the original benefit. An example of this is where a licensee receives a grandfathered benefit from a product issuer as a result of one its employees recommending one of the issuer's products – the arrangement which gives rise to the benefit is between the product issuer and the licensee, not the agreement between the licensee and the individual employee. The licensee may pass the benefit on to its employee as long as it is consistent with the purpose under which gave rise to the original benefit. That is the grandfathered benefit was originally paid to the licensee for recommending the particular issuer's product. In order for the benefit to be passed on, the agreement under which the benefit is passed-on must have been entered into before the application day and the benefit must be paid as a consequence of the employee recommending the issuer's products.

In this example, where the licensee passes the benefit onto an employee for a different purpose, for example under a post-application day arrangement or as a broader performance bonus, the benefit would not be exempt from the ban on conflicted remuneration, as it was not passed through for the same purpose which gave rise to the grandfathered benefit.

In addition, the regulation prevents an amount being passed through that exceeds more than 100 per cent of the grandfathered benefit. The intention is that the 'benefit' for the purposes of this regulation is exclusive of any Goods and Services Tax attached to the actual payment of benefit.

ATTACHMENT B

Statement of Compatibility with Human Rights

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

Corporations Amendment Regulation 2013 (No. 5)

This Legislative Instrument 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 of the Legislative Instrument

The *Corporations Amendment Regulation 2013 (No. 5)* (the Regulation) amends the *Corporations Regulations 2001*. The amendment is in respect of the provisions in Parts 7.7A and 10.18 of the *Corporations Act 2001*, dealing with the ban on conflicted remuneration. Specifically, the Regulation deals with the application of the ban on conflicted remuneration and excludes some benefits from the ban on conflicted remuneration.

The Regulation outlines the application of the ban on conflicted remuneration. As a result of the Regulation the ban will apply to new clients from 1 July 2014 for platform operators and investments in new products from 1 July 2014 for non-platform providers.

In addition, the Regulation excludes from the ban on conflicted remuneration certain benefits made in relation to the purchase or sale of a financial advice business and the payment of benefits to third parties after the commencement of the ban that result from an arrangement entered into before 1 July 2013.

Human rights implications

This Legislative Instrument engages the right to earn a living through work and the right to an adequate standard of living in Articles 6 and 11 of the International Covenant on Economic, Social and Cultural Rights (ICESCR).

By extending the application of the ban on conflicted remuneration, this Legislative Instrument engages the right to earn a living through work by limiting the circumstances in which financial product advisers are able to receive monetary or non-monetary benefits through conflicted remuneration arrangements. However, the arrangements introduced by this Legislative Instrument are necessary to protect consumers from the risk of detriment that could result from receiving financial product advice that is influenced by a conflicted remuneration arrangement that the licensee is a party to. Through protecting consumers from conflicted advice, this Legislative Instrument promotes the right to an adequate standard of living in Article 11 of the ICESCR.

Conclusion

This Legislative Instrument is compatible with human rights as it promotes the right to an adequate standard of living in Article 11 by strengthening investor protections, thereby protecting the personal wealth and living standards of consumers.