

## **EXPLANATORY STATEMENT**

### **Issued by authority of the Treasurer**

#### *Corporations Act 2001*

#### *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019*

Section 1364 of the *Corporations Act 2001* (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 purpose of the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019* (the Regulations) is to amend the *Corporations Regulations 2001* to provide for a scheme by which conflicted remuneration in relation to financial product advice that remains payable on or after 1 January 2021 will be rebated to affected retail customers by means of payments or other monetary benefits. The Regulations also place record-keeping requirements on Australian financial services licensees who are required to rebate conflicted remuneration.

The Regulations also repeal provisions that grandfather conflicted remuneration that are contained in the *Corporations Regulations 2001*.

On 28 October 2019, the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019* (the Amending Act) received Royal Assent. The Amending Act removes grandfathering arrangements for conflicted remuneration and other banned remuneration from 1 January 2021. Schedule 1 to the Amending Act commences on 1 January 2021.

The Regulations, together with the Amending Act, implement the Government's response to Recommendation 2.4 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

The Amending Act allows for regulations to be made that provide a scheme under which benefits that would otherwise have been paid as conflicted remuneration are rebated to affected retail clients.

The Regulations apply to a person covered by section 963M of the Act, contained in item 9 of Schedule 1 to the Amending Act (a covered person). A covered person is a person who would be legally obliged to pay conflicted remuneration to another person on or after 1 January 2021 but for the ban on conflicted remuneration in Subdivision C of Division 4 in Part 7.7A of the Act. Generally, the covered person is a product issuer and the person receiving the payment of conflicted remuneration is a financial services licensee, a financial adviser or an authorised representative of the financial services licensee.

From 1 January 2021, instead of being paid to the financial services licensee, the financial adviser or the authorised representative, the conflicted remuneration must instead be rebated to product holders in a just and equitable way. The conflicted remuneration may be rebated in the form of a cash payment or in the form of another monetary benefit (for example, a reduction in fees). The amounts of money paid or monetary benefits provided must be just and equitable in the circumstances.

The Regulations require financial services licensees who are covered persons to keep records of the conflicted remuneration that they are legally obliged to pay (disregarding the prohibition in Subdivision C of Division 4 of Part 7.7A of the Act) from 1 January 2021.

Additionally, the Regulations impose requirements on these covered persons to keep records of how and when conflicted remuneration was rebated on or after 1 January 2021.

The Regulations apply from 1 January 2021. The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*.

On 28 March 2019, the Government released a version of these regulations for four weeks of public consultation. The Government received 10 submissions including feedback from consumer groups, industry and the Australian Securities and Investments Commission. Since then, Treasury has undertaken further targeted consultation on the Regulations.

The Act does not specify any conditions that need to be met before the power to make regulations may be exercised.

Further details of the Regulations are set out in [Attachment A](#).

A Statement of Compatibility with Human Rights is at [Attachment B](#).

**Details of the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019***

**Section 1 – Name of Regulations**

This section provides that the title of the instrument is the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019* (the Regulations).

**Section 2 – Commencement**

This section provides that the Regulations commence on 1 January 2021.

**Section 3 – Authority**

This section provides that the Regulations are made under the *Corporations Act 2001* (the Act).

**Section 4 – Schedule**

This section provides that each instrument specified in a Schedule to the Regulations is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to the Instrument has effect according to its terms.

**Schedule 1 – Amendments**

**Item 1**

Item 1 in Schedule 1 to the Regulations amends the *Corporations Regulations 2001* (the Corporations Regulations) to provide for a scheme under which persons that are legally obliged to pay conflicted remuneration after 1 January 2021 (disregarding the ban on conflicted remuneration in Subdivision C of Division 4 of Part 7.7A of the Act) must pay amounts or provide monetary benefits based on that conflicted remuneration to product holders. Those persons are persons covered by section 963M of the Act<sup>1</sup> (a covered person). Product holders are defined by subsection 963N(3) of the Act<sup>2</sup> to include persons that hold the product directly or indirectly through a third party that hold the product on that person's behalf.

Subregulation 7.7A.15AJ(1) in item 1 in Schedule 1 to the Regulations provides that the new Subdivision containing the rebate scheme (Subdivision 4A of Division 4 of Part 7.7A of the Corporations Regulations) is made for the purposes of subsection 963N(1) of the Act.<sup>3</sup>

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<sup>1</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

<sup>2</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

<sup>3</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

The obligation on covered persons under the rebating scheme extends only to payments of conflicted remuneration banned under Subdivision C of Division 4 of Part 7.7A of the Act. It does not extend to other remuneration banned under Division 5 of Part 7.7A of the Act such as volume-based shelf-space fees and asset-based fees on borrowed amounts.

*Obligation to provide a rebate within one year*

A covered person must pay amounts or provide monetary benefits to the product holders no later than one year after the date by which the covered person is legally obliged (disregarding the ban) to give the conflicted remuneration to another person. The benefit may be paid directly by the covered person to the product holder (for example, in the form of a cash rebate) or indirectly (for example, through a reduction in a product-based fee that the product holder is required to pay). This one year limit allows a monetary benefit to be provided by means of a reduction in a product-based fee, which are frequently charged on an annual basis (subregulation 7.7A.15AK(1), item 1, Schedule 1).

*Rebates must be just and equitable*

Subregulation 7.7A.15AK(2) in item 1 of Schedule 1 to the Regulations provides that the amounts paid, or the amounts of the monetary benefits provided, to the product holders must be amounts that are just and equitable in the circumstances. Whether the amounts paid or the amounts of monetary benefit provided are just and equitable is not determined according to the subjective opinion of the covered person. The just and equitable test sets an objective standard which a covered person's rebating scheme must meet.

The covered person has a choice of whether to provide a rebate by paying an amount directly to the product holder or indirectly by providing some other monetary benefit such as reducing a fee that the product holder would have otherwise been required to pay. The regulations provide the flexibility for covered persons to provide the rebate through either mechanism as long as they comply with the just and equitable obligation.

Providing a monetary benefit through a reduction in product fees may be suitable in situations where a rebate is to be provided to all product holders. Covered persons should also have regard to their other legal obligations, such as the obligation on responsible entities to treat members of the same class equally in section 601FC of the Act, in deciding the mechanism by which to provide rebates.

In determining whether the amounts paid, or the amounts of the monetary benefit provided, are just and equitable, subregulation 7.7A.15AK(3) provides that the following matters must be taken into account:

- the amount of the conflicted remuneration that would have been payable. The definition of conflicted remuneration takes its meaning from the Act, and will refer to any amount which has been grandfathered by section 1528 of the Act. This includes remuneration that *would* influence financial product advice if any advice was provided. This means it covers remuneration that did not directly fund financial product advice provided to clients (paragraph 7.7A.15AK(3)(a));

- the amount invested by each product holder in the financial products mentioned in subsection 963N(2)<sup>4</sup> of the Act (paragraph 7.7A.15AK(3)(b)). In general, for an amount to be just and equitable, product holders with more invested should receive a larger rebate;
- the structure of the fees (if any) that the product holders have paid in respect of those financial products (paragraph 7.7A.15AK(3)(c)). This is relevant to determining whether the product holder has incurred the cost of the conflicted remuneration and therefore should receive a rebate;
- the extent to which the sum of the amounts to be paid and the amount of the monetary benefits to be provided to the product holders under subregulation 7.7A.15AK(2) equals the amount of, or the present value of, the conflicted remuneration referred to in paragraph (a) (paragraph 7.7A.15AK(3)(d)); and
- any other relevant matter (paragraph 7.7A.15AK(3)(e)). These could, for example, be factors unique to an individual product holder that need to be taken into consideration to determine the rebate that the specific product holder receives. A lack of information or records is not a relevant matter in determining whether the amounts paid, or the amounts of the monetary benefit provided, are just and equitable.

The overarching just and equitable test is intended to provide some flexibility to covered persons so that the amount of rebates provided does not need to precisely match the amount of conflicted remuneration. However, the matters in paragraphs 7.7A.15AK(3)(a) and (d) have the effect that the total amount of monetary benefits provided to product holders must, in aggregate, closely match the conflicted remuneration that would otherwise have been paid by the covered person. Situations where it would be just and equitable for the covered person to pay out less than the conflicted remuneration are expected to be rare.

There may be situations where the cost of conflicted remuneration is spread across the entire population of product holders but the conflicted remuneration only relates to financial product advice provided to a subset of the population of product holders. In these situations, it would be just and equitable to provide a rebate to the entire populations of product holders rather than just the subset of product holders that received financial product advice.

In relation to some financial products, it may be just and equitable to pay a one-off lump sum to clients reflecting the present value of future conflicted remuneration. This is contemplated by paragraph 7.7A.15AK(3)(d). This approach may be appropriate for products such as annuities where the length of time the client will be in the product is known (for example, fixed term annuities or endowments) or where the term can be determined based on life expectancy (for example, lifetime annuities or whole of life conventional products) and the amount of conflicted remuneration to be paid is known. Where a lump sum is paid, the present value should be determined assuming no future voluntary surrender of the product. In situations where there is uncertainty around the total amount of conflicted remuneration to be paid over the

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<sup>4</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

duration that the client holds the product, it is unlikely that a one-off payment would be just and equitable.

Providing such a lump sum can be consistent with the requirement in subregulation 7.7A.15AK(1) that payments or benefits are provided 'no later than' one year after the day by which the covered person is legally obliged to give the conflicted remuneration, as the sum is provided ahead of when payments would have been made in the future.

Under subregulation 7.7A.15AK(4), the costs of providing the monetary benefit to product holders is not a matter that a covered person can take into account when determining whether an amount is just and equitable. For example, a covered person may not deduct administrative costs from the payments that they are required to make.

It is possible for a person to incur the cost of conflicted remuneration even though that person has never received advice. In these cases, whether or not the product holder received financial product advice (including whether or not the covered person has records of the product holder receiving financial product advice) will not be a relevant factor in determining whether a covered person has distributed a monetary benefit in a just and equitable manner. In general, it will not be just and equitable for a covered person to stream the benefits to a subset of product holders unless it can be shown that it is only that subset of product holders that incurred the cost of conflicted remuneration.

A nil amount for a particular product holder may also be just and equitable where a product holder holds the financial product on behalf of another product holder. In this situation, both people are product holders within the meaning of subsection 963N(3) of the Act.<sup>5</sup> However, as one holds the legal title to the product for the benefit of the other, it may not be just and equitable to provide rebates to both. In these circumstances, it is expected that the ultimate owner of the product will receive the benefit of the rebate, regardless of who it may be provided to initially. For example, if a platform holds the product on behalf of another person it would not be just and equitable if the platform retained the benefit of the rebate: it would need to be passed through to the client, or paid directly to the client. If a covered person elected to provide a rebate to the ultimate product holder through an intermediary (such as a platform), this will only be just and equitable if the covered person has agreements in place with the intermediary to ensure the intermediary passes the benefit through to the ultimate product holders. If the covered person is not able to secure these arrangements, the covered person must find an alternative means of ensuring the benefit is passed through to the ultimate product holder.

In order to be just and equitable it is not necessary for the monetary benefit provided to a product holder to exactly reflect the cost imposed on the product holder by the conflicted remuneration. In many cases, it is likely to be very difficult for covered persons to determine this calculation.

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<sup>5</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

*Examples of compliance with the just and equitable test*

**Example 1 - Fund X:**

In Fund X, there are 3,000 product holders. Only 500 of those product holders received financial product advice associated with conflicted remuneration. The responsible entity for Fund X (the covered person) is legally obliged (disregarding Subdivision C of Division 4 of Part 7.7A of the Act) to pay \$5,000 in conflicted remuneration in relation to those 500 product holders. The cost of funding that \$5,000 is spread across the entire population of product holders given that all the product holders pay the same product fee regardless of whether they received advice associated with conflicted remuneration. In this situation it would be just and equitable for the covered person to provide the rebate back to all product holders through a reduction in product fees rather than providing the rebate just to the subset of product holders directly associated with the conflicted remuneration.

**Example 2 - Platform Y:**

In Platform Y, the platform operator (the covered person) is legally obliged (disregarding Subdivision C of Division 4 of Part 7.7A of the Act) to pay \$500 million in conflicted remuneration. In order to rebate this amount to product holders (in this case, people using Platform Y), the covered person calculates that it would need to cut its platform administration fees by 10 basis points. At the end of the period, the covered person calculates the actual monetary benefit received by product holders because of the fee reduction. It turns out that because of an unexpected reduction in the number of people using the platform and the value of funds invested through the platform, the amount of the monetary benefit rebated to product holders was slightly less than the amount of the conflicted remuneration.

Assuming the covered person has a reasonable basis for calculating the amount of fee reduction needed to rebate the amount of conflicted remuneration, it would be fair to conclude that Platform Y provided monetary benefits that were just and equitable in the circumstances. In this situation, it would be expected that Platform Y would correct for the lower number of product holders in future periods and give a larger reduction in the platform administration fee.

A pattern of behaviour where a covered person consistently paid out less than the amount of the conflicted remuneration over a number of years, even by a small amount, is likely to indicate that the monetary benefits being provided are not just and equitable.

**Item 2**

Item 2 of Schedule 1 to the Regulations repeals Subdivision 5 of Division 4 of Part 7.7A of the Corporations Regulations. This Subdivision prescribes further grandfathering of arrangements entered into before the relevant application day specified in the Act, generally 1 July 2013. Repealing this Subdivision removes the grandfathering arrangements prescribed in that Subdivision.

### Item 3

Item 3 of Schedule 1 to the Regulations inserts a new regulation 7.8.11B into the Corporations Regulations.

Regulation 7.8.11B requires a financial services licensee who is a covered person to keep certain records, to enable monitoring of compliance with the rebating requirements in regulation 7.7A.15AK in item 1. It is made for the purposes of paragraph 988E(g) and section 988F of the Act, which relate to the record keeping obligations of financial services licensees.

Subregulation 7.8.11B(1) requires financial services licensees who are persons covered by section 963M of the Act<sup>6</sup> to keep records for each financial year. These records must show particulars of: (a) all conflicted remuneration the licensee is legally obliged (disregarding Subdivision C of Division 4 of Part 7.7A of the Act) to give to another person for a financial year; (b) all amounts paid and monetary benefits provided to clients by the licensee as required by regulation 7.7A.15AK for a financial year and all cases where the financial services licensee determined that an amount that was just and equitable was nil.

Subregulations 7.8.11B(2) and (3) impose additional record keeping requirements on financial services licensees who are covered persons.

The records the financial services licensee must keep are:

- an explanation of how the licensee ascertained the identity of the product holders;
- an explanation of how the licensee determined the amounts that, in the circumstances, were just and equitable to pay or provide to the product holders, including an explanation of nil amounts. This should include an explanation of the discrepancy if the total amount of payments and monetary benefits provided to product holders does not match the conflicted remuneration;
- a description of the financial product or products to which the conflicted remuneration relates (including the name or names of the product or products). This must also include any product identification numbers of that product (or product identification numbers of those products));
- the dates by which the licensee was required under regulation 7.7A.15AK to pay the amounts or provide the monetary benefits;
- the date or dates on which the amounts were paid or the monetary benefits were provided; and,
- a description of the manner in which the was amounts were paid or the monetary benefits were provided.

The record keeping requirements are scalable to the rebating that occurs by the covered person. If records relating to individual product holders are not required to explain how benefits have been passed through (for example, as a result of a reduction

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<sup>6</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.



of fees for all product holders), then it is not envisaged that records would be required to be kept for individual product holders.

#### **Item 4**

Item 4 of Schedule 1 to the Regulations inserts a new Part 10.33 into Chapter 10 of the Corporations Regulations.

Regulation 10.33.01 provides that the amendment made by Item 2 of Schedule 1 to the Regulations (repealing the grandfathering provisions in Subdivision 5 of Division 4 of Part 7.7A of the Corporations Regulations) applies to a benefit given on or after 1 January 2021, if the benefit is given under a previously grandfathered arrangement.

Regulation 10.33.02 provides that the amendment made by Item 3 of Schedule 1 to the Regulations (record-keeping requirements for financial services licensees who are covered by section 963M of the Act<sup>7</sup>) applies to financial records relating to periods ending after 1 January 2021.

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<sup>7</sup> As inserted by item 9 of Schedule 1 to the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019*.

## **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) Regulations 2019***

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 purpose of the *Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019* (the Regulations) is to amend the *Corporations Regulations 2001* to provide for a scheme by which conflicted remuneration that remains payable on or after 1 January 2021 will be rebated to affected retail customers by means of payments or other monetary benefits. The Regulations also place record-keeping requirements on Australian financial services licensees who are required to rebate conflicted remuneration.

The Regulations also repeal provisions that grandfather conflicted remuneration that are contained in the *Corporations Regulations 2001*.

## **Human rights implications**

This Legislative Instrument does not engage any of the applicable rights or freedoms.

## **Conclusion**

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.