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By Email

Dear Director

Submission – Quality of Advice Tranche 1

1 Introduction

This submission is made by Herbert Smith Freehills (**HSF**) in response to the Exposure Draft *Treasury Laws Amendment (2024 Measures No. 1) Bill 2024: Quality of Advice Tranche 1 (Exposure Draft Legislation)*.

HSF is an international law firm with 24 offices located around the globe and which specialises in, amongst other things, financial services and financial services regulation, including in relation to financial product advice.

We wish to respond to the proposed amendments to the conflicted remuneration regime in Chapter 7 of the *Corporations Act 2001* (Cth) (**Corporations Act**), in particular the proposed removal of the exception to the conflicted remuneration provisions for benefits given by a client for the issue or sale of a financial product (which we will refer to as the **Client-paid Dealing Exception**).

Our submission in relation to the Client-paid Dealing Exception is set out in section 2 below. In our view, the removal of that exception is not consistent with the recommendations made in the Quality of Advice Review Final Report (**QAR Final Report**).

We also wish to make a number of other comments and submissions regarding the scope and operation of the conflicted remuneration regime, as well as the proposed amendments to section 962T of the Corporations Act and section 99FA of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**), which are set out in section 3 below.

2 The Client-paid Dealing Exception

2.1 Proposed amendments

The Exposure Draft Legislation proposes to amend the definition of ‘conflicted remuneration’ in section 963A of the Corporations Act to exclude benefits which are ‘given to the licensee or representative by a retail client in relation to financial product advice given by the licensee or representative to the client’ (section 963A(1)(b); emphasis added).

The Exposure Draft Legislation also proposes to repeal the whole of sections 963B(1)(d) and 963C(1)(e) of the Corporations Act, which currently provide exceptions from the conflicted remuneration provisions for monetary and non-monetary benefits given by the client in relation to either the issue or sale of a financial product, or financial product advice.

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These amendments would create a gap in the conflicted remuneration regime in that benefits given by a client in relation to the issue or sale of a financial product would no longer be expressly exempted from being conflicted remuneration.

2.2 The proposed amendments are inconsistent with the QAR Final Report

This outcome is inconsistent with the recommendations made in the QAR Final Report, which included that:

- (a) the conflicted remuneration provisions in the Corporations Act be amended to 'explicitly provide that both monetary and non-monetary benefits given by a client to an AFS licensee or a representative of a licensee are not conflicted remuneration' (Recommendation 13.1); and
- (b) if the recommendation that permits benefits (monetary and non-monetary) given by clients to an AFS licensee or a representative is accepted, the exceptions in sections 936B(1)(d)(i) and 963C(1)(e)(i) of the Corporations Act and regulation 7.7A.12E of the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**) are no longer required and should be removed (Recommendation 13.2).

The recommendation that the exceptions referred to in paragraph 2.2(b) would no longer be required was based on a recommendation that 'the operative provisions or the definition of conflicted remuneration... are amended to make clear that they do not prohibit a client giving monetary or non-monetary benefits to an AFS licensee or representative for any service – advice or dealing' (QAR Final Report at [9.3.5]; emphasis added).

However, as noted above, the proposed amendments only exclude from the definition of conflicted remuneration benefits which are given by a client 'in relation to financial product advice', leaving a gap for:

- (c) benefits given by a client in relation to the issue or sale of a financial product; and
- (d) if regulation 7.7A.12E is also removed, in relation to a 'provider dealing in a financial product on behalf of the client'.

The QAR Final Report also states that the exceptions referred to in paragraph 2.2(b) are unnecessary and proceed on the basis of a misunderstanding or nervousness about the reach of the conflicted remuneration provisions (at [9.3.5]). It states that the exception for benefits provided in relation to the issue or sale of a financial product 'is difficult to reconcile with the primary conflicted remuneration provision to which it is an exception – which bans benefits that influence financial product advice – not benefits which influence the issue or sale of a financial product' (at [9.3.1]).

However, in our view, benefits given by a client to a licensee or representative in relation to the issue or sale of a financial product to the client or dealing on behalf of the client can clearly fall within the definition of conflicted remuneration in section 963A. For example, this could occur where:

- the client pays a licensee a fee for services they receive in connection with the licensee's issuing of a financial product to them, and the licensee also provides general advice to the client in the course of their interaction; or
- a financial adviser is involved in, and receives fees for services they provide in relation to, the issuing of a financial product to a client, where the financial adviser is not the issuer of the product or issues the product under a binder. In



this respect, we note that the courts appear to be taking a broad view of the concept of ‘issuing’ under the Corporations Act.¹

The test for whether that fee is conflicted remuneration is objective and imposes a low threshold. In our view, it is possible that a court could determine that benefits which influence or relate to the issue or sale of a financial product to a client or dealing on behalf of a client could also reasonably be expected to influence the choice of financial product recommended or the financial advice given by the licensee or representative, including where those benefits are given by the client as fees for services provided by the licensee or representative.

2.3 Conclusion

To address the issues we have raised in this submission, we submit that the words that appear after ‘by a retail client’ in the proposed section 963A(1)(b) of the Corporations Act should be deleted.

Alternatively, we submit that the exceptions in sections 936B(1)(d)(i) and 963C(1)(e)(i) of the Corporations Act and regulation 7.7A.12E of the Corporations Regulations should be retained.

3 Further submissions

3.1 The intended scope of the conflicted remuneration regime

As pointed out in the QAR Final Report (at [9.3.1]), the conflicted remuneration provisions were not intended to apply to benefits which are given to a licensee or representative by a client.

The Revised Explanatory Memorandum to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 (Revised Explanatory Memorandum)* described the rationale for the exception for monetary benefits given by the client as follows (at [2.26]; emphasis added):

Where the monetary benefit is given by the client in relation to the issue or sale of a product or in relation to financial product advice provided to the client, this is not conflicted remuneration. This ensures that ‘fee for service’ arrangements — where the client is the person paying the adviser — are not conflicted remuneration (even where the client pays a volume-based fee). The provision is intended to exclude from the definition of conflicted remuneration any fee for service paid by the retail client, whether the benefit is given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client.

In this section, we set out a number of submissions which are intended to support this policy position and provide further clarity in relation to what benefits may be provided by a client to a licensee or representative without breaching the ban on conflicted remuneration.

(a) ‘Causing or authorising’ a benefit to be given

The note to the proposed section 963A(1) states:

A reference in this Subdivision (including sections 963A, 963AA, 963B and 963C) to giving a benefit includes a reference to causing or authorising it to be given (see section 52).

On 20 October 2023, the *Treasury Laws Amendment (2023 Law Improvement Package No. 1) Act 2023 (Cth) (Amending Act)* repealed section 52 of the Corporations Act and replaced it with a definition of ‘doing’ in section 9 of the

¹ For example, in *Australian Securities and Investments Commission v MobiSuper Pty Ltd* [2021] FCA 855 the trustee’s ‘issuing’ conduct was taken to extend to its monitoring of the distribution of the product.



Corporations Act. That new definition of 'doing' states that 'doing an act or thing includes causing or authorising the act or thing to be done.'

We also note that section 5C of the Corporations Act, which 'froze' the *Acts Interpretation Act 1901* (Cth) (**AIA**) in time in relation to its application to the Corporations Act, was repealed by the Amending Act on 20 October 2023. One of the effects of this is that section 13 of the AIA now applies to the Corporations Act, such that the notes to sections of the Corporations Act are taken to be part of that Act and can be used in considering the meaning of particular provisions (including section 963A(1)).

While the note to section 963A(1) appears intended to clarify that the concept 'given by' will be satisfied where the benefit is authorised or caused to be given by the relevant person, the note purports to apply to the whole of the Subdivision, not only section 963A(1). There is a question as to whether this note ought to be used to construe the remaining sections in the Subdivision, such as proposed section 963B(1)(bb)(ii) (which refers to benefits given by trustees of a regulated superannuation fund).

We recommend that, this issue could be resolved by the insertion of a new provision which expressly states that, for the purposes of the Subdivision, a benefit will be 'given by a person' where it is authorised or caused to be given by them.

However, if this submission is not accepted, in the alternative the note to the proposed section 963A(1) should be updated to reflect section 9 of the Corporations Act rather than section 52.

(b) **Clarifying when benefits are 'given by a client'**

The proposed section 963A(2) states:

For the purposes of paragraph (1)(b), a benefit is given by a retail client only if the benefit is paid by the retail client, or on behalf of the client (including from one or more financial products in which the client has a beneficial interest).

The exposure draft explanatory materials for the Exposure Draft Legislation (**Exposure Draft Explanatory Materials**) indicate that the new definition of conflicted remuneration in section 963A is intended to apply so that a benefit given to a financial services provider will not be conflicted remuneration in the following circumstances (at [1.168]):

- The benefit is given directly by a retail client or a retail client authorises another party to give the benefit on their behalf.
- The benefit is paid by the retail client, or on behalf of the client, including from one or more financial products in which the retail client has rights or benefits.
- The benefit is given in return for the provision of financial product advice that the retail client has requested or agreed to receive.

However, in our view, proposed section 963A(2) leaves some room for uncertainty as to when a benefit will be 'paid... on behalf of the client'.

ASIC's current regulatory guidance concerning the conflicted remuneration regime in Regulatory Guide 246 (**RG 246**) requires that benefits 'given directly by the client or by another party on behalf of the client' are given using the client's own funds and are not paid out of fees paid to another licensee or representative (RG 246.54; RG 246.61-246.62).



In our view, it should not be necessary for a benefit to meet these requirements to fall into the exception for benefits which are given by a client. In particular, it is not clear why a client should not be able to authorise a portion of the fees they pay to one licensee or representative be passed on to another licensee or representative for services that other licensee or representative has provided.

This position appears to be consistent with the intention expressed in the Exposure Draft Explanatory Materials for benefits which a retail client authorises another party to give on their behalf to be excluded from the definition of conflicted remuneration.

We also consider it to be consistent with the Revised Explanatory Memorandum extracted in section 3.1 above, which referred to the intention to exclude from the definition of conflicted remuneration any fee for service paid by the retail client, whether the benefit is given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client.

To address this issue, we submit that proposed section 963A(2) should be updated to state:

For the purposes of paragraph (1)(b), a benefit is given by a retail client to the licensee or representative (**Receiving Licensee or Representative**) only if the benefit is paid by the retail client, or on behalf of the client, including:

- (a) from one or more financial products in which the client has a beneficial interest; and
- (b) from fees, premiums or other payments made by the client to another financial services licensee or representative of a financial services licensee, which the client has directed or authorised be passed on to the Receiving Licensee or Representative.

(c) **Volume-based benefits**

We also submit that the legislation should, for the avoidance of doubt, provide that benefits given by a client to a licensee or representative may be volume-based.

In our view, without this clarification, there is a risk that volume-based benefits could be regarded as prohibited, even when given by a client, on the basis of an implied rationale that the exception for benefits given by the client should be subject to some limitation on the value or method of calculation of the benefit – for example, having regard to the presumption in section 963L of the Corporations Act that volume-based benefits are conflicted remuneration.

This is not consistent with the intention to exclude from the scope of the conflicted remuneration regime all benefits which are given by the client.

Therefore, we submit that an additional paragraph should be inserted into section 963A(2) to the following effect:

For the purposes of paragraph (1)(b), the value of the benefit given by a retail client may be wholly or partly based on the number or total value of the financial products:

- (a) recommended by the licensee or representative to the client; or
- (b) acquired by the client.

3.2 **Transferability of client consent or authorisation**

- (a) **Client request or consent for cost of financial product advice to be charged against their superannuation interest**



We also wish to address the proposed replacement of section 99FA of the SIS Act and section 962T of the Corporations Act.

New section 99FA will require the trustee of a regulated superannuation fund to hold a written request or consent from a member before charging the cost of providing financial product advice against the member's interest in the fund.

If the arrangement under which the advice is provided is an ongoing fee arrangement, section 99FA(1)(d) will require 'any applicable requirements of Division 3 of Part 7.7A of the Corporations Act' to be met. This includes section 962T of the Corporations Act, which sets out content requirements for an account holder's consent for the deduction of ongoing fees from their account. New paragraph 962T(c) will require that 'the consent specifies the name of the account holder and the other details of the account.'

If the arrangement under which the advice is provided is not an ongoing fee arrangement, new section 99FA(1)(e) will require the request or consent to satisfy the content requirements in section 99FA(2). New paragraph 99FA(2)(c) will require that the written request or written consent include 'the name of the fund from which the cost of the advice is requested to be paid.'

New sections 962T and 99FA do not contemplate that the details of a member's superannuation account and the name of the member's fund changing if their interest is subsequently transferred to a successor fund. In these circumstances, the trustee of the successor fund would not be able to rely on consent or requests given by the member to the trustee of their previous fund for the purposes of paragraphs 99FA(1)(d) or 99FA(1)(e) of the SIS Act, because those consents and requests will no longer accurately identify the details of the member's account or the name of their fund (as applicable).

This would require the successor trustee to cease paying advice fees until all transferring members provide updated consents. We submit this would be impractical and have the potential for member detriment, as members may lose access to advice until their consent is renewed. As a matter of practice, an incoming trustee of a superannuation fund does not generally undertake an exercise of re-obtaining all of the consents, nominations, directions and elections made by members of the fund.

We submit that an additional provision should be inserted into section 99FA of the SIS Act and section 962T of the Corporations Act to clarify that a new written consent or request is not required in these circumstances.

This would align with the approach taken in new section 963BB(3) of the Corporations Act, which allows a client's consent for the charging of certain insurance commissions to be transferred to a new licensee or representative in the context of the sale or transfer of the relevant financial product advice business to the new licensee or representative.

It is also similar to the approach taken in *ASIC Corporations and Superannuation (Amendment) Instrument 2023/512 (ASIC Instrument 2023/512)*.

ASIC Instrument 2023/512 modified *ASIC Corporations (Consent to Deductions—Ongoing Fee Arrangements) Instrument 2021/124 (ASIC Instrument 2021/124)* and *ASIC Superannuation (Consent to Pass on Costs of Providing Advice) Instrument 2021/126 (ASIC Instrument 2021/126)* so that a new written consent would not need to be obtained due to a change in:

- the name of the account holder or the name and contact details of the fee recipient (in the case of ASIC Instrument 2021/124); or



- the name of the member or the name and contact details of the provider of the financial product advice (in the case of ASIC Instrument 2021/126),

after the consent was signed.

Accordingly, we submit that:

- (1) in new section 962T an additional provision to following effect should be inserted:
 - (7) For the purposes of this section, the requirement in paragraph (c) is taken to be met if, in relation to an account held in a registrable superannuation entity:
 - the name of the account holder specified in the consent is the account holder's name at the time the account holder signs the consent; and
 - the other details of the account specified in the consent are the details of the account at the time the account holder signs the consent,and the account holder's interest in the account is transferred to a successor fund;
- (2) in new section 99FA, an additional provision to following effect should be inserted:
 - (8) For the purposes of paragraph (1)(e), a consent is taken to meet the requirements of paragraph (2)(c) if the consent includes the name of the fund from which the cost of the advice is requested to be paid at the time the member signs the written request or written consent and the member's interest is later transferred to a successor fund.

Further, any advice to which section 99FA of the SIS Act applies may relate to the member's interest in either their previous fund or the successor fund. Accordingly, we submit that references in sections 99FA(1)(a), (1)(b) and (2)(e) to the member's interest in the fund should be expanded to include the member's interest in either their previous fund or the successor fund.

(b) **Client consent for benefits given to a licensee or representative**

For similar reasons, we also submit that a client's consent or authorisation for benefits to be given to a representative should be capable of being transferred in situations where that consent or authorisation is given in relation to a representative of a licensee who later becomes the representative of a different licensee. For example, this may occur through a restructure of licensees held within a single corporate group or the sale of a business from one licensee to another.

3.3 **Asymmetry of certain monetary and non-monetary benefits**

Finally, we submit that the current exceptions for non-monetary benefits given in the circumstances set out in section 963C should apply equally to monetary benefits given in the in the same circumstances.

In particular, we submit that the rationale for the exemption of benefits which:

- have a genuine education or training purpose and is relevant to the carrying on of a financial services business; and



- are for the provision of information technology software or support and the benefit is related to the provision of financial product advice to persons as retail clients in relation to the financial products issued or sold by the benefit provider, applies regardless of whether the benefit is given in its non-monetary form or a monetary benefit is given for these prescribed purposes.

Thank you for providing us the opportunity to comment on the Exposure Draft Legislation. If you would like to discuss the matters raised in this submission, please contact any of us at the details below.

Yours sincerely

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