

24 April 2019

The Treasury  
Financial Services Reform Implementation Taskforce  
Langton Crescent  
PARKES ACT 2600

BY Email: FOFAGrandfathering@treasury.gov.au

Dear Sir/Madam,

Industry Super Australia (**ISA**) appreciates the opportunity to provide comment on the Exposure Draft Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations 2019 (**Exposure Draft**), the purpose of which is to amend the Corporations Regulations 2001 to provide for conflicted remuneration that remains payable after 1 January 2021 to be rebated to affected retail customers or passed on in the form of a monetary benefit.

ISA strongly opposes the Exposure Draft proposal that grandfathered conflicted remuneration be allowed to continue.

The Regulations together with the Exposure Draft Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Bill 2019 (the **Bill**) provide the Government's response to Recommendation 2.4 of the Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Final Report**).

Commissioner Hayne recommends that grandfathering provisions for conflicted remuneration be repealed as soon as reasonably practicable.<sup>1</sup>

The Bill proposes the repeal of the grandfathered conflicted remuneration provisions take effect from 1 January 2021 and the Regulations basically provide an exemption to the blanket prohibition by allowing a rebate/monetary benefit scheme to be set up (as well as record keeping obligations).

ISA does not support the proposal set out in the Exposure Draft relating to the provision of a rebate or monetary benefit for the reasons set out below.

Despite universal political acceptance of Commissioner Hayne's recommendation that grandfathered conflicted remuneration for financial advisers should cease, the proposed regulations allow conflicted remuneration to **remain payable after 1 January 2021**. The proposed regulations are completely at odds with Commissioner Hayne's recommendation.

Some may argue that:

- ▶ whilst the conflicted remuneration will remain payable only for *a person legally obliged to pay*; and

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<sup>1</sup> Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, p 185

- ▶ it will be rebated to affected retail customers or passed on in the form of a monetary benefit,

it has the effect of meeting Commissioner Hayne's recommendation.

This argument is flawed; Commissioner Hayne's recommendation and observations are unmistakable, the time for commissions has come to an end. His report was clear:

*"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 they have outlived their validity"<sup>2</sup>. [Emphasis added]*

The proposal does not achieve an end to commissions and in fact the arrangements which underpin the allowances being made will be complex and likely to give rise to different interpretations. For example, how will "just and equitable" be interpreted? The determinative factors listed in the proposed regulations are broad and rely on a subjective assessment. There is a real risk that consumer harm will eventuate and that the same circumstances might not produce the result that a reasonable person would expect, as we saw through the Royal Commission case studies. For example, in one study<sup>2</sup> which dealt with grandfathered commissions and successor fund transfers it was determined that maintaining payments of grandfathered commissions that were being paid by members of the fund to advisers were:

1. lawful under the FoFA legislation to grandfather commissions after an successor fund transfer; and
2. in the best interest of members to do so.

Importantly, Commission Hayne noted that:

*"For present purposes I need say no more than that this view of how the relevant provisions of the Act operate may be thought not to leap from the page of the statute"<sup>3</sup>.*

This is the type of unnecessary risk the current proposed regulations will expose consumers to.

Additionally, the Explanatory Memorandum for the Exposure Draft (EM) notes:

*"a person **legally obliged** to pay conflicted remuneration to another person ....., but for the ban on conflicted remuneration in Subdivision C of Division 4 in Part 7.7A of the Act".*

The EM is unhelpful in describing what type of legal obligations apply and, in any event, it is unclear why the Corporations Act is not amended to cease the legal obligation, with prospective effect, for conflicted remuneration to be paid to another person. The rebate arrangements assume that the legal obligation continues and if there is no rational reason for the obligation to continue there is no need for the rebate.

Some may also argue that the carve out is necessary because of the way rebates are structured.

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<sup>2</sup> Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 2, p 39, paragraph 1.2.2

<sup>3</sup> Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 2, p 39,40

While it is accepted that it may be an administrative inconvenience to unwind some of these inbuilt conflicted remuneration structures, it is not a legitimate reason for abandoning Commissioner Hayne's recommendation. Administrative inconveniences should not usurp adequate law reform.

It is important to remember that grandfathered commissions remove money from consumers' accounts, without their express consent. Moreover, the advisers receiving these commissions are rewarded for no effort. This is adviser money for nothing, which would otherwise be maintained by the consumer. In this context any attempt to water down a blanket prohibition to ending grandfathered commission cannot be justified.

During the Royal Commission Mr Comyn, Managing Director and Chief Executive Officer of the Commonwealth Bank of Australia described:

*"the decision to lobby for the grandfathering exemption as a "poor decision"<sup>4</sup>.*

It seems that this is another example of poor decision making and a refusal to acknowledge that consumers will be negatively affected by the proposed rebate/monetary benefit scheme. Allowing product issuers to avail themselves of a rebate/monetary scheme which can incentivise advisers to continue to recommend that clients remain in existing commission-based products undermines Commissioner Hayne's recommendation. The weakening of consumer protection can only cause harm at both an individual and industry level.

Finally, it is difficult to provide meaningful comment on the proposed rebate concessions without having a more detailed understanding of the administrative and legal arrangements which seem to be generating the concessions. The EM provides no insight into this, when they should. Without a clear and compelling basis for a departure from Commissioner Hayne's recommendation, this proposal must be rejected.

#### ISA RECOMMENDATIONS:

1. Reject the proposal for a rebate or monetary benefit scheme which allows conflicted remuneration to continue after the repeal date.
2. End grandfathered conflicted remuneration with effective from 1 July 2019.

We appreciate the opportunity to comment on the Exposure Draft. Please do not hesitate to contact me with any questions on (03) 9657 4333.

Yours sincerely



**Kathy Roden**  
Senior Legal Counsel

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<sup>4</sup> Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, p 185