22 December 2011

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
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Dear Sir,

CORPORATIONS AMENDMENT (FUTURE OF FINANCIAL ADVICE) BILL 2011 NO. 2011 AND THE CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011 NO. 2011

I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia on *Corporations Amendment (Future of Financial Advice) Bill 2011 No. 2011* and the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 No. 2011.*

Yours sincerely,

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Corporations Amendment (Future of Financial Advice) Bill 2011 No. 2011 and the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 No. 2011*

Parliamentary Joint Committee on Corporations and Financial Services

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia.

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The Superannuation Committee (**Committee**) is a committee of the Legal Practice Section of the Law Council of Australia. Its objectives include ensuring that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. It fulfils this objective in part by making submissions and providing comments on the legal aspects of proposed legislation, circulars, policy papers and other regulatory instruments.

In this submission, the Committee provides comments on some legal aspects of the *Corporations Amendment (Future of Financial Advice) Bill 2011 No. 2011* and the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 No. 2011* (together the **Bill**).

Summary

The key provisions of the Bill are <u>intended</u> to:

- promote the quality of financial advice and, at the same time, broaden access to affordable financial advice; and
- prohibit the receipt and payment of conflicted remuneration by Australian financial services <u>licensees</u> and their representatives in order to ensure that retail clients have access to unbiased advice.

In addition the Bill will introduce measures to ensure that clients pay ongoing fees to financial advisers only with their express consent. It will also broaden ASIC's powers when dealing with Australian financial services licensees and introduce anti-avoidance provisions. Again, these measures are intended to enhance the quality of financial advice to retail clients and reduce conflicts of interest in the financial services industry.

The Committee is concerned that the likely impact of the Bill will be much broader than is necessary to ensure that retail clients have access to unbiased financial product advice. It also thinks that many provisions of the Bill will introduce a significant degree of uncertainty for financial advisers and product issuers. In order to promote compliance, legislation should be clear and certain. In addition, the Bill will, if passed in its present form, have unintended and potentially negative consequences on superannuation funds and their members. In summary the Committee is particularly concerned about:

- the breadth of ASIC's discretion to refuse to grant an Australian financial service licence, to cancel a licence and to make a banning order;
- the apparent "mislabelling" of the proposed best interests obligation and the associated provisions;
- the prospect that product fees will be included in ongoing fee arrangements;
- the breadth of the definitions of conflicted remuneration, platform operator and volume-based shelf-space fee;
- the failure of the Bill to address the issue of adviser fees being deducted from members' interests in superannuation funds;
- the scope of the anti-avoidance provision; and
- the failure to provide certainty to industry in the transitional provisions.

Significant issues for superannuation trustees and their members include:

- the prospect that administration fees paid to fund administrators (who also provide financial product advice, including only general advice) could be conflicted remuneration; and

- that members of superannuation funds will not be able to direct a trustee to deduct adviser service fees agreed with their adviser from their interest in the fund.

More detail about the Committee's concerns is provided below.

ASIC Powers

The Bill will broaden ASIC's powers to allow ASIC to refuse to issue an Australian financial services licence, cancel a licence or make a banning order where it has reason to believe that the applicant or licensee is "likely to contravene" their obligations as a licensee.

The Committee is concerned by the breadth of the discretion these powers give to ASIC. There is no standard of proof which must be satisfied by ASIC and no prescription of the matters which go to whether a person is "likely to contravene" their obligations. Given the consequences that can flow from an exercise of ASIC's powers under new sections 913B(1)(b), 915C(1)(aa), 920A(1)(f) and 920A(1)(h), including the closure of a licensee's business, the Committee submits that what is required in order for ASIC to form the view that a licensee is "likely to contravene" their obligations should be subject to greater certainty.

Best Interests Obligations

Content and structure of the obligation

The Bill will introduce a statutory duty for a person who provides personal advice to act in the best interests of the client in relation to the advice (section 961B(1)). The provider can discharge their statutory duty either by performing the steps in section 961B(2) of by some other means.

Meaning of duty

The Committee is very concerned that the proposed statutory best interests duty in section 961B(1) does not accord with either the general law duty of a fiduciary to act in the best interests of their client (in the case of a financial adviser) or beneficiary (in the case of a trustee or responsible entity) or the existing statutory best interests duties for superannuation trustees (section 52(2)(c) of the SIS Act) or for responsible entities and their directors (sections 601FC(1)(c) and 601FD(1)(c) of the Corporations Act).

The general law says that a duty to act in another person's best interests requires a person to act for a proper purpose (to further the other person's interests), to act without a conflict of interest or duties except with consent and not to make an unauthorised profit. The best interests duty at general law is therefore concerned with the provider's motives. In very stark contrast, section 961B(2) sets out the steps the provider should take in providing advice. If the provider proves that they have done each of these things, they will satisfy their duty to act in the best interests of their client under section 961B(1). However, the steps in section 961B(2) are all matters which, at general law, go to the adviser's duty of care. They therefore strongly imply that an adviser's best interests duty under section 961B has been mislabelled and is more akin to the adviser's duty of care at general law rather than to their fiduciary duties. This gap between what the general law says about a best interests duty (as well as the case law interpreting a superannuation trustee's duty to act in the best interests of their members under section 52(2)(c) of the

SIS Act) and what section 961B calls a best interests duty will raise significant uncertainty for the providers of advice and their advisers in determining what is required by a provider in order to discharge their duty and to satisfy the steps set out in section 960B(2).

While it might be reasonable to say that mislabelling does not matter where the law provides a clear means by which a provider can comply with their duty, this is not the case here. Although section 961B(2) provides that a provider will be deemed to comply with their statutory best interests duty if they prove that they have satisfied all of the steps in section 961B(2), section 961B(2)(g) effectively takes away the certainty the opening words offer. It requires the provider to have: "*taken any other step that would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances*". In other words, a provider will comply with their statutory duty to act in the best interests of their client if they prove that they have acted in the best interests of their client. The statutory defence in section 961B(2) therefore gives providers no comfort at all that if they follow the prescribed steps they will have discharged their obligation and leaves them with the difficult task of determining what the statutory duty to act in the best interests of their client means.

By adopting a phrase which is the subject of a great deal of judicial and academic discussion and using it in a way which is substantially different, the Bill will make it very difficult for providers of advice to understand their obligations and to know what they need to do to comply with their duty. Since section 961B(1) applies in addition to any other obligations under the law, for providers of advice with other best interests duties at general law (like most financial advisers) and statute (like superannuation trustees), the problems will be compounded.

Amendment

For these reasons the Committee considers that it is essential that the best interests obligation define with specificity and certainty the precise ambit of an adviser's obligations.

In the Committee's opinion, the law could go a long way to achieving these aims if the steps in section 961B(2) omitted paragraph (g), that is the obligation to take "*any other step that would reasonably be regarded as being in the best interests of the client*". Using a term other than "best interests" would also assist to ensure that the duty in section 961B(1) is not muddied by the jurisprudence concerning "best interests". A better name for the duty in section 961B might be the duty to take reasonable steps when giving advice. Given that the steps in section 961B(2) are an expanded version of the duties found in section 945A of the Corporations Act (the existing duty to have a reasonable basis for advice), this approach would be consistent with the existing law and clear. Providers would have a good understanding of what they need to do in order to discharge their statutory duty.

Duty of priority

Section 961J will impose a duty of priority on a provider of advice. It will apply where there is a conflict between the interests of the client and the interests of the provider or certain other people.

The Committee notes that, in contrast to the duty imposed on responsible entities in section 601FC(1)(c) of the Corporations Act, this duty is not linked to the best interests duty in section 961B. This makes some sense given that the best interests duty does not conform to its general law meaning, but also raises its own difficulties. In particular, it is unclear how a provider who has a conflict can discharge their duty of priority. In contrast with the duty to act in the best interests of another person, there is no jurisprudence considering a duty of priority notwithstanding its proliferation in legislation. The term was,

so far as the Committee understands, first used in the Life Insurance Act 1995 to describe the duty of a life company to policy owners in recognition that a life company does not have a duty to act in the best interests of policy owners. What does it mean to give priority to another person's interests and can a person who has a conflict fairly or objectively judge what is required to give priority?

The Committee notes that the general rule against a fiduciary acting with a conflict was developed because judges formed the view that a person with a conflict could not be trusted to form a view about what was in another's interests or to act in another person's interests. Given this, the Committee considers that it would be appropriate to include in the legislation steps which could be taken by a provider of advice to discharge their duty of priority. ASIC guidance would also be very helpful.

Best interests duties for superannuation fund trustees

As noted above, where a superannuation trustee provides personal advice (for example intra-fund advice), it will be subject to its best interests obligations to members at general law and under the SIS Act and to the particular member under section 961B(1) of the Corporations Act. It is very likely that at least in some cases those duties might conflict.

For example, a conflict of statutory duties might arise (and a trustee-adviser should be expressly permitted to abstain from providing advice) in cases where it becomes apparent that the appropriate advice would involve advising the member:

- to switch out of the fund, thereby detracting from economies of scale (taking into account the potential cumulative impact of providing such advice on numerous occasions to different members) and adversely affecting the remaining members as a whole;
- to crystallise or convert a defined benefit (e.g. into a transition-to-retirement pension) in order to avoid the risks associated with a falling vested benefit index by ensuring that the particular member receives full value for their accrued benefit, but thereby disadvantaging other defined benefit members in the process;
- to switch out of a particular investment option while the option is still sufficiently liquid, in cases where the trustee knows that the option has limited liquidity and that switches out of that option may imminently be suspended or frozen; or
- to switch into (or out of) a particular investment option in order to take advantage of an imminent revaluation of assets or other gain (or loss) which the trustee knows has not yet been reflected in unit prices or crediting rates.

Read literally, the duty of priority will require the trustee to give priority to the individual member when providing advice in any of these circumstances to the members as a whole. However, it is by no means clear that this position is intended or considered. It is also by no means clear that the duty to the member will override the trustee's competing duty to the members as a whole. In the Committee's opinion, a trustee must be able to refrain from giving advice in a situation where its statutory duties might conflict.

The Committee submits that this matter of potential conflict of statutory duties for superannuation fund trustees should be considered further so that the obligations are clear for this important sector of the financial services industry. This should be considered as part of the intra-fund advice proposals.

Ambit of obligation and limited advice

One of the objectives of FOFA is to facilitate limited advice including, in the context of superannuation, intra-fund advice.

In the Committee's view, the Bill does not do so and section 961B may in fact inhibit limited or intra-fund advice in two ways:

- first, it is not clear that an adviser can limit advice; and
- second, the cost of complying with the steps in section 961B(2) may well be disproportionate to the value of the advice or the amount which the provider can recover for providing the advice.

Ambit of advice

Currently, the ambit of the advice is required to be determined primarily by the subject matter of the advice requested by the client.

This then carries over into various obligations to make further investigations in relation to the needs and objectives of the client, again with these concepts being defined by the largely unidirectional interaction arising from the client instructing the adviser.

As currently drafted, disgruntled clients may well contest any limitation in the scope of advice – for example, on the basis that it ought to have been reasonably apparent to the adviser that the client's instructions were incomplete or that the client should have requested advice on a different subject matter and that, therefore, the adviser failed to satisfy the proposed section 961B(2)(c). The current formulation imposes a substantial risk that advisers will simply avoid giving personal advice altogether.

The Committee believes more needs to be done to facilitate limited advice, including intra-fund advice. In particular, the legislation should explicitly state that limited advice can be provided. It should be clear that the scope of the advice can be limited by the adviser or the client. In the case that it is limited by the adviser, the client's interests can be protected by requiring the adviser to explain the limitations of their advice. The legislation could require the scope of the advice to be set out in writing.

Cost of advice

The Committee is concerned that there may be a material cost implication for providers of limited advice and superannuation trustees providing intra-fund advice in complying with the proposed new section 916B generally. Clearly there will be time and cost implications because of the range of matters expected to be considered. These factors will act as a significant disincentive to providers of limited advice including intra-fund advice.

In the Committee's opinion, providers of limited advice and intra-fund advice will need greater assistance to promote such advice, including relief from some of the more onerous obligations under section 961B(2).

Specific drafting comments

In the balance of this section, the Committee makes some comments on specific provisions of Division 2 of Part 7.7A.

Meaning of "client"

Section 961B refers to obligations of the provider in giving advice to the "client". However, the obligations in the section arise prior to the time at which for the purposes of the Corporations Act the recipient (or prospective recipient) can be characterised as a client for the purposes of the Act. Take for example the situation where there is some preliminary discussion that occurs between a prospective client and an adviser. In this case, where the adviser has not committed to taking the person on as a client, the Committee is of the view that the obligations should not be triggered and that this should be made clear in the drafting. In other words, there should perhaps be an express provision to the effect that the relevant provisions do not apply in circumstances in which the adviser does not actually provide advice to the client.

Computer programs

There is a reference to offering personal advice through a computer program in section 961(6). However, some of the factors in section 961B require human judgement. The Committee is concerned that this obligation cannot be met as obviously a computer program (for example an online calculator or risk profiler) cannot judge these types of matters.

Reasonably apparent

In section 961B(2)(c) the term "reasonably apparent" is used (which in turn is defined in section 961C). The Committee queries whether this is the correct test. Ultimately it adds a layer of difficulty because circumstances are always clearer in hindsight.

Advice based on inaccurate or incomplete information

Section 961H requires an adviser to warn the client if advice is based on incomplete or inaccurate information. Having regard to industry practice which has evolved in response to the general advice warning provisions, it seems likely that a warning along the lines of that contemplated by section 961H would simply become a standard or pro forma inclusion in documentation, even in cases where it is not strictly required. This raises a question of whether it would actually serve to distinguish advice based on incomplete information from comprehensive advice.

The Committee queries how section 961G interacts with section 961H. Section 961G requires the advice to be appropriate had the adviser satisfied the duty under section 961B to act in the best interests of the client. This includes making reasonable enquiries to obtain complete and accurate information. Section 961H allows advice to be given based on incomplete and inaccurate information. The Committee queries whether it is clear that section 961H can still be satisfied in that situation. Is it enough to show that reasonable enquiries were made?

Charging of ongoing fees

Definition and operation of ongoing fee arrangement provisions

The Bill will introduce, in Division 3 of Part 7.7A, rules dealing with charging ongoing fees. Broadly, they require annual fee disclosure by an adviser and the express consent of a client to the charging of ongoing fees every two years. The section is intended to ensure that clients understand the fees they pay to their adviser and that they consent to the payment of these fees. However, as currently drafted the provisions will have a much wider and unintended application.

The provisions turn on the definition of an "ongoing fee arrangement" which is defined in section 962A(1) and (2).

In summary there is an ongoing fee arrangement if:

- a licensee or a representative provides personal advice to a retail client;
- the client enters into an arrangement with the licensee or representative; and
- under the terms of the arrangement, a fee (however described or structured) is to be paid during a period of 12 months or more.

Interpretation and the Committee's recommendations

There are a number of difficulties with the definition. In the first case and very significantly, while there cannot be an ongoing fee arrangement unless a licensee or representative provides personal advice, the arrangement and the fee need not relate to the advice. It is enough that personal advice has been provided to the client. The definition will capture product fees where the product issuer is a licensee and either the licensee or a representative of the licensee has provided personal advice to the product holder.

Clearly this is not intended and the Committee understands that the regulations will exclude product fees from the definition. However, given the importance of the exclusion, the Committee considers that product fees should be expressly excluded from the definition in the Act, in the same way as premiums for insurance policies are (the Committee notes that premiums are one example of a product fee).

In the second case, the words "however described or structured" are extremely unclear. The drafting should be modified so as to make it clear what types of arrangements will be caught by these words. In particular, do they apply to arrangements which involve fees being paid *in respect of* the client, even if the client does not in fact make the payment personally and even if the payment is made out of assets which are technically not the client's own assets (as in the case of superannuation account balances)?

If this is the case, the Committee queries the implications for superannuation trustees if the giving of personal intra-fund advice becomes compulsory under the Stronger Super reforms.

Sections 962G and 962K

- Section 962G requires the fee recipient to give the client a fee disclosure statement within a period of 30 days beginning on the disclosure day for the arrangement. The disclosure day is the anniversary of the day the client entered into the fee arrangement, or the anniversary of the day the last disclosure statement was given (section 962J). This obligation is likely to cause difficulties for ongoing fee arrangements entered into prior to the commencement of the section. (These arrangements will be subject to ongoing fee disclosure, but do not need to be renewed.) In many cases the date such an arrangement was entered into may not be available. In other cases, the information which is required to be included in a fee disclosure statement may not have been kept.
- In the Committee's opinion, relief from timing and content requirements should be given to ongoing fee arrangements entered into prior to the commencement of the section.

Conflicted remuneration

General ban

Section 963E(1) provides that a licensee must not accept "conflicted remuneration". Similarly section 963G(1) provides that an authorised representative must not accept conflicted remuneration and section 963H provides that a representative (other than an authorised representative) must not accept conflicted remuneration except in certain circumstances.

Section 963J also prohibits an employer of a licensee or a representative of a licensee giving conflicted remuneration to the licensee or representative conflicted remuneration and section 963K prohibits an issuer or seller of financial products giving a licensee or representative conflicted remuneration.

Definition of conflicted remuneration

Conflicted remuneration is defined in very general terms in section 963A. In addition, under section 963L, certain volume based benefits are presumed to be conflicted remuneration unless the contrary is proved and sections 963B, 963C and 963D exclude certain benefits from being conflicted remuneration.

General definition

The Committee is concerned that the general definition of conflicted remuneration is not limited to remuneration for personal advice, nor even for financial product advice more generally, paid by the product issuer to the adviser.

Definition not limited to remuneration for personal advice

Any fee or charge may be conflicted remuneration under the general definition in section 963(1) if the licensee or its representative provides financial product advice to a retail client which could have the necessary influence. For example, a product issuer who provides general financial product advice (for example in the form of a product disclosure statement), could be prohibited by the ban on conflicted remuneration from receiving a management fee as the fee could be interpreted as being capable of influencing its general advice to investors. It could also prevent trustees of superannuation funds paying fees based on assets under administration or the number of members to fund administrators (who also provide general or personal advice to members).

While the amendment of the definition which was contained in the Exposure Draft of the Bill from "might influence" to "could reasonably be expected to influence" is welcome and does reduce the prospect for these kinds of payments to be characterised as conflicted remuneration, the definition still leaves room for differences of opinion and argument.

The Committee would therefore like to press for these kinds of product fees and service fees to be excluded from the definition by regulation. Section 963B(e) of the Bill provides for benefits to be excluded by regulation.

Benefits which are presumed to be conflicted remuneration

Section 963L will presume that certain benefits are conflicted remuneration unless the contrary is proved. The benefits are benefits that are wholly or partly "dependent" on the value or number of the financial products being recommended. By including "partly dependent" in the benefits which are presumed to be conflicted remuneration, it is clear that benefits which include a component which is dependent on the value or number of financial products recommended will be conflicted remuneration. This will be particularly

relevant in the remuneration of employees who are entitled to bonuses and bonuses which include any component which is dependent on meeting sales targets, for example, will be presumed to be conflicted remuneration.

While the Committee agrees that not all volume based benefits are conflicted remuneration, it has a real concern about how the section will operate in practice. On what basis can it be proved that a volume based benefit is not conflicted remuneration and to whom? Read literally, a volume based benefit will be conflicted remuneration until such time as it is proved not to be. In the Committee's opinion, the provision does not give any certainty to the industry or to employers. It opens the possibility of employers taking a view that some component of an employee's remuneration can be linked to sales or performance without that remuneration being conflicted remuneration in circumstances where ASIC or a court may subsequently take a different view. The industry and employers require more certainty.

The Committee queries whether, instead of or in addition to the ability to "prove" that a volume based benefit is not conflicted remuneration, section 963L should also include a materiality threshold. The Committee also queries whether a ruling system could be introduced to the legislation such that ASIC could be asked to consider specific benefits are conflicted remuneration (or not) and provide a ruling or determination that those benefits are not conflicted remuneration.

Benefits which are not conflicted remuneration

Section 963B(1)(d) states that benefits given to a licensee or its representatives are not conflicted remuneration if the benefits are given to the licensee by the client in the relevant circumstances.

The Committee has two key concerns about section 963B(1)(d):

- it is not clear that a fee paid by a product issuer, albeit at the direction of a client would be a benefit "given to the licensee or representative by a retail client"; and
- the exception will not apply where a retail client wishes to pay their adviser from their interest in a superannuation fund.

It is clear from the Explanatory Memorandum that the exception is intended to allow:

- an adviser and client to agree the adviser's fee, including an asset-based fee; and
- the adviser's fee to be satisfied by the product issuer deducting the fee from the client's product and paying the adviser.

However, it is not clear that section 963B(1)(d) (nor any other section) will allow a client/investor to direct the product issuer to deduct an amount from their product and pay it to their adviser. There is a question about whether such a payment would be given to the licensee "by" the client. In the context of superannuation the issue is even more pressing. The SIS Act prevents a client and adviser cannot enter into an arrangement under which the client agrees to pay the adviser a fee by directing the trustee of the client's superannuation fund to deduct the fee from their interest in the fund. The SIS Act will prevent the trustee acting on the direction of the client and prevent the cashing of the benefit in many cases.

Currently these arrangements are commonly dealt with by tripartite arrangements between the trustee, member/client and adviser. As between the trustee and adviser, the trustee is liable to pay the adviser's fee.

The Committee notes that it has previously made submissions on this point to Treasury in relation to the Exposure Draft Bill. It appears that an attempt has been made to address these comments by amendments to the Explanatory Memorandum. It now provides at paragraph 2.26 that:

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.

The problem with this statement and the approach is that it does not reflect what the section provides for. Further, the Explanatory Memorandum cannot be used to change the meaning of the express and clear terms of the section. The Committee notes that the rules of statutory interpretation only allow a court to have regard to the Explanatory Memorandum for a Bill where the legislation is unclear. In this case, section 963B(1)(d) is not unclear. But it does not allow a trustee to pay a benefit to a financial adviser of its member notwithstanding the "clear consent" of the member.

In the Committee's opinion, section 963B(1)(d) should be amended to expressly provide that the exception is satisfied where a product issuer makes a payment from a product at the direction of the client or otherwise with the consent of the client.

Volume-based shelf-space fees

Operation of the ban

Section 964A prohibits a "platform operator" accepting a benefit if it is a "volume-based shelf-space fee".

The section (and the ban) apply only where:

- a financial services licensee or an RSE licensee (the platform operator) offers or provides a custodial service; and
- a benefit is given by a licensee or an RSE licensee (funds manager) to the platform operator; and
- a financial product to which the custodial arrangement relates is a financial product in which the funds manager deals.

The platform operator is defined by reference to custodial arrangement in section 1012IA of the Corporations Act and as a consequence the ban has a narrower operation than was proposed in the Exposure Draft Bill. The Committee welcomes these changes.

Nevertheless, many superannuation trustees do provide custodial arrangements for the purposes of section 1012IA and will be platform operators for the purposes of the section. The effect of including superannuation trustees as platform operators may be that the superannuation funds and their members may lose the benefit of any favourable fee arrangements that have been negotiated by the trustee for the benefit of members with the issuers of the pooled products in which those funds invest, resulting in higher costs for members.

More details of the Committee's concerns are set out below.

Rebates and discounts

The Committee notes that there is no definition of volume-based shelf-space fee in section. Instead, section 964A(2) presumes that volume based benefits are volume-based shelf space fees unless, under section 964A(3) they are proved to be a benefit of the kind specified in that sub-section.

Again, the combination of a presumption and an opportunity to prove that the presumption is not correct leads to great uncertainty for the industry.

The benefits which are presumed not to be volume-based shelf-space fees are:

- a reasonable fee for service provided to the funds manager by the platform operator or another person; and
- a discount on an amount payable, or a rebate of an amount paid, to the funds manager by the platform operator, the value of which may be reasonably attributed to efficiencies gained because of the number or value of financial products.

It therefore appears that fund managers are not able to offer wholesale asset management fees to platform operators unless the difference between the wholesale rate and the "rack" rate paid by other investors can be justified as a reasonable assessment of the costs the fund manager will save by offering its product through the platform.

As a consequence, this means that any rebates which have been negotiated by these superannuation trustees would be prohibited under the new legislation, especially if the amount of the rebate exceeds any efficiency savings of the kind referred to in section 964A(3)(b). In this regard, it is critical to note that some large superannuation funds are able to negotiate very favourable rebate arrangements which in some cases will far exceed mere efficiency savings. The crucial distinguishing factor in the context of superannuation funds (as opposed to other platform operators) is that superannuation trustees are required by law to hold all rebates for the benefit of their members and cannot retain those rebates for their personal benefit.

Suggested amendment

The Committee considers that this would be an unintended and undesirable consequence of the legislation. In the Committee's view, a better result for investors/members would not be to prohibit such discounts or rebates but, instead, to require any discount or rebate to be passed on to the investors/members.

The Committee therefore suggests that the legislation be amended:

- to exclude trustees of superannuation funds from the definition of "platform operators" (this would involve removing the ban on RSE licensees accepting a volume-based shelf-space fee, and providing that the ban on AFS licensees accepting a volume-based shelf-space fee does not apply where the licensee is also an RSE licensee); and/or
- to introduce an additional exception that applies in cases where volume-based shelf-space fees are not received for the benefit of the platform operator but are instead received for the benefit of the retail clients who have accessed the relevant financial products through the facility operated by the platform operator.

If these changes are not made, there is a real risk that superannuation funds and their members will lose the benefit of existing rebate arrangements (especially the more favourable of those arrangements), with the result that members of superannuation funds will suffer an increase in their superannuation fund's investment fees.

Anti-avoidance

Section 965 will address schemes to avoid the operation of Part 7.7A.

The Committee's key concern is that, as currently drafted, section 965 would not apply just to a scheme entered into on or after 1 July 2012, but also to a scheme entered into before 1 July 2012 but only carried out on or after that date. This begs the question, how far in advance of 1 July 2012 could a scheme be entered into and still run the risk of contravening section 965? Before the Bill receives Royal Assent? Before it is passed by Parliament? Before it was introduced into Parliament? This uncertainty in relation to the commencement of the anti-avoidance measure is, in the Committee's view, something which needs to be resolved.

Compare the position with what was clearly the model (at least in part) for section 965 – Part IVA of the Income Tax Assessment Act 1936. Section 177D expressly states that Part IVA does not apply to a scheme that was entered into on or before 27 May 1981. In a similar way, section 965 should expressly state that it does not apply if the scheme was entered into on or before a specified date. In the Committee's opinion, a start date should be clearly identified.

Existing contractual rights

The Bill contains the transitional provisions relating to the commencement of FOFA although the Committee notes that many of those provisions will be contained in the regulations. The Committee notes the importance for industry of knowing which of its existing arrangements will be subject to the Bill and which will not. In the Committee's opinion, draft regulations should be published urgently.

Under section 1528(1) the ban on conflicted remuneration will not apply to a benefit provided under an arrangement entered into before the commencement date unless the benefit is given by a platform provider. While it is difficult to comment with certainty without the benefit of the regulations, the Committee is concerned about the different treatment of platform providers. Further, the Committee notes that as currently drafted a product issuer could be a platform provider in respect of one product but not another, for example a superannuation trustee may be the trustee of a fund which would be a custodial arrangement under section 1012IA and another fund which is not. The trustee will be a "platform provider" and will be subject to the same treatment in respect of the first and second funds notwithstanding that only one fund (or even part of one fund) is a "platform".

Under section 1530 regulations will not apply to the extent that the operation of the regulations would result in an acquisition of property (within the meaning of paragraph 51(xxxi) of the Constitution) from a person other than on just terms. Similarly, under section 1531(2) the commencement of the ban on asset-based fees charged on borrowed amounts does not apply to the extent that it would result in such an acquisition of property. These provisions leave it open to a person to argue that a regulation or section does not apply to an arrangement because it would be an unlawful acquisition of property. In the Committee's opinion, this is inappropriate. It should not be left to a licensee or a representative of a licensee to argue that a section of the Act or a Regulation is unconstitutional. The scope of paragraph 51(xxxi) is difficult. However, it is incumbent on the Government to take advice and determine the extent to which it must protect existing

remuneration rights. It is not appropriate to leave it to individual action by licensees or their representatives.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 56,000 Australian lawyers, through their representative bar associations and law societies (the "constituent bodies" of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- Australian Capital Territory Bar Association
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society of the Australian Capital Territory
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar Association
- The Victorian Bar Inc
- Western Australian Bar Association
- LLFG Limited (a corporation with large law firm members)

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.