

11 September 2025

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## **Submission to ASIC on Consultation Paper 385**

Kit Legal is a law firm solely providing legal services to the financial services industry. We act for over 120 financial services firms around Australia, assisting them to comply with their regulatory obligations. Most of our clients are SMEs that hold their own AFSL.

We welcome ASIC's review of Regulatory Guide 181 *Licensing: Managing conflicts of interest* and its efforts to provide clearer guidance on identifying and managing conflicts across the financial services sector.

Our submission focuses on the increasing prevalence of **vertical integration** and the growth of **in-house products**, particularly offerings for wholesale clients and, for retail clients, separately managed accounts (SMAs) within advice businesses, and how ASIC's proposed guidance can be strengthened to address these developments in a meaningful and practical way.

### **Proposal B1**

The proposed guidance clarifying that the conflicts management obligation is broad and is intended to apply to all conflicts of interest other than those wholly outside the financial services business of a licensee or its representatives is clear.

### **Proposal B2**

The proposed guidance clarifying how the conflicts management obligation operates in connection with other legal obligations of an AFS licensee (including other AFS licensing obligations) is helpful and clear, particularly the reference to fiduciary obligations which are often overlooked.

### **Proposal B3**

The proposed guidance on types of conflicts of interest that an AFS licensee should consider is appropriate.

### **Proposal B4**

The illustrative examples of the types of conflicts of interest that an AFS licensee may need to consider could be improved.

### ***Vertical Integration and In-House Products (SMAs)***

Vertical integration is becoming more popular, particularly with wholesale client offerings that can be distributed by the advice arm of a financial services business. This may occur under the one AFSL by different corporate entities or involve multiple AFSLs held by the same corporate group or with common shareholders.

Similarly, white labelled or internally managed SMAs and other in-house investment products are becoming increasingly popular for advice firms to achieve business efficiencies. In most cases, the advice firm will not be the issuer of the product but will be appointed the investment manager or enter into a white-labelled arrangement.

While these arrangements are not always detrimental to a client and may in many cases have client benefits, they create structural conflicts that are not well understood and require more explicit recognition in RG 181.

In our view, ASIC's guidance should:

- Clarify that a conflict exists at the point where an adviser or advice licensee is owned by, distributes or advises on a product issued by either itself or an entity affiliated with the licensee – irrespective of disclosure or client consent.
- Provide some analysis of the types of conflicts and spectrum of risk that can arise in this context – ranging from layered fee structures, potential lack of objectivity in making and assessment of the risks and benefits to a client of a particular product, financial benefits that may be received by the firm such as discounted investment consulting or research and the potential (significant) conflict between seeking business efficiencies and clients' best interests.

### ***Specific Comments on Proposed RG 181 Examples in Table 1***

We think that some of the examples in Table 1 of the proposed revised RG181 could be improved to make them more relevant.

#### **1. Conflicts with clients or members (page 10)**

- **First dot point:** We recommend removing the reference to “disclosure” as a means of negating a conflict. A conflict exists even where disclosure is made, as disclosure does not remove the underlying divergence of interest but is one method of managing it.
- **Third dot point:** We recommend ending the example at “fees to members”. The subsequent reference to “not in their best financial interests” risks trivialising the conflict by creating ambiguity. While the specific “best interests” duty is a statutory protection for retail clients under the Corporations Act, a similar obligation for wholesale clients is not captured under the Corporations Act, but a core principle of common law. The phrase could lead to a wholesale fund incorrectly assuming this conflict doesn't apply to them.
- **Fourth dot point:** We recommend ending the example at “...a related entity.” The subsequent reference to “hedging and seeking to generate revenue from client losses” is highly unlikely in typical advice contexts and risks trivialising more common and material conflicts. The example should instead focus on realistic conflicts faced by advisers and licensees.

#### **2. Structural conflicts (page 11)**

- **Fourth dot point:** We recommend expanding this to cover “any product issuer owning, or being aligned to, an advice firm” to capture a more diverse range of licensees (including those dealing with wholesale clients) rather than just a super fund trustee or RE.

#### **3. Third-party conflicts (page 11)**

- **First dot point:** The current example is unclear in scope. ASIC should provide further explanation, ideally with an example showing a realistic scenario (e.g., where a licensee's referral relationship with a third party could compromise the best interests of clients).

### **Proposals B5, B6 and B7**

Some more illustrative examples about what adequate arrangements could involve in the context of in-house products would be helpful. This includes:

- Providing practical guidance about managing such conflicts beyond just disclosure or consent, such as fee structures, independent members involved in product approval committees, genuine alternative product comparisons, ongoing review of client concentration in in-house products, benchmarking of fees and performance and strict limits on adviser remuneration linked to in-house product flows.
- Addressing the challenges for smaller licensees that are using 'in-house' products but may lack the governance resources of large institutions.

### **Conclusion**

We support ASIC's aim of ensuring licensees identify and appropriately manage conflicts of interest, particularly in light of market structures that embed conflicts at the ownership and product design level.

By refining the examples in Table 1 and strengthening guidance on vertical integration and in-house products such as SMAs, ASIC can help ensure the regulatory framework remains both relevant and practical.

We would be happy to discuss these recommendations further.

The team at Kit Legal.