FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

22 March 2019

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

Email: FOFAGrandfathering@treasury.gov.au

Dear Treasury

RE: Ending Grandfathered Conflicted Remuneration for Financial Advisers

The Financial Planning Association of Australia thanks the Treasury for the opportunity to comment on the exposure draft of a Bill to remove grandfathered commissions.

The Government's proposal to remove grandfathered commissions on investment and superannuation products is consistent with the FPA's longstanding policy on remuneration for financial advisers. Moving away from grandfathered commissions is an important step in the professionalisation of financial planning. The FPA supports the phasing-out of grandfathered commissions on the basis that the Government meets a range of principles, notably: that consumers are not left worse off by the change; that the Government provides for the rebating of commissions to consumers; and that the Government addresses potential unintended tax and social security consequences.

We are concerned by the lack of detail included in the draft Bill, including details that would indicate the Government is going to satisfy these principles. While we understand the Government intends to create regulations to manage the rebating of commissions, this creates added uncertainty for industry particularly given the shortened timeframe in which the Government proposes to introduce this reform.

The FPA would welcome the opportunity to discuss with the Taskforce any issues raised in our submission. If you have any questions, please contact FPA's Head of Policy, Ben Marshan (ben.marshan@fpa.com.au) or myself (dante.degori@fpa.com.au) on 02 9220 4500.

Yours sincerely

Dante De Gori
Chief Executive Officer
Financial Planning Association of Australia

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Ending grandfathered commissions

The FPA acknowledges the Government's proposal to end the grandfathering arrangements for commissions on investment and superannuation products that were introduced at the time of the Future of Financial Advice reforms in 2013. The Government's proposal is consistent with the FPA's 2009 Financial Planner Remuneration Policy.

The FPA's Financial Planner Remuneration Policy is based on some fundamental principles, including that consumers who are well informed and well educated make better decisions about their finances. To this end, the FPA supports advice fees that are simple, able to be easily understood by consumers, and comparable. The FPA believes that consumers, not product providers, should pay advice fees.

Grandfathered commissions on investment and superannuation products are inconsistent with these principles and have led to an environment where some consumers are paying implicit advice fees via commissions and yet receiving no services. With the Future of Financial Advice reforms having commenced five years ago, it is time to identify an appropriate means of transitioning from grandfathered commissions to an alternative remuneration model.

The FPA has previously submitted to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that grandfathered commissions on investment and superannuation products should be phased out over a three-year transition period to give advisers time to move from commission-based revenue to fee-for-service arrangements. While the proposed deadline of 1 January 2021 is a shorter period, it is the principle of providing an appropriate transition period that is important, rather than the specific length of that period.

Impact on financial advisers

Research undertaken by CoreData on behalf of the FPA in 2018 demonstrates the role of commissions in contemporary financial planning.

Overall, commissions on investment and superannuation products comprise an average of 8.3 per cent of revenue for FPA members. A significant reduction in this proportion occurred when the Future of Financial Advice reforms were introduced in 2013. Immediately prior to these reforms, commissions accounted for 17 per cent of revenue. Since the reforms were introduced five years ago, the level of commission revenue has remained relatively steady at between 8 and 10 per cent.

Commission revenue is not evenly spread across all FPA members. CoreData's research indicates around half of FPA members derive no revenue from commissions on investment and superannuation products. At the other end of the scale, around 1 in 10 FPA members receive 30 per cent or more of their revenue from these commissions. A small number of advisers receive more than 50 per cent and up to 85 per cent of their revenue from commissions.

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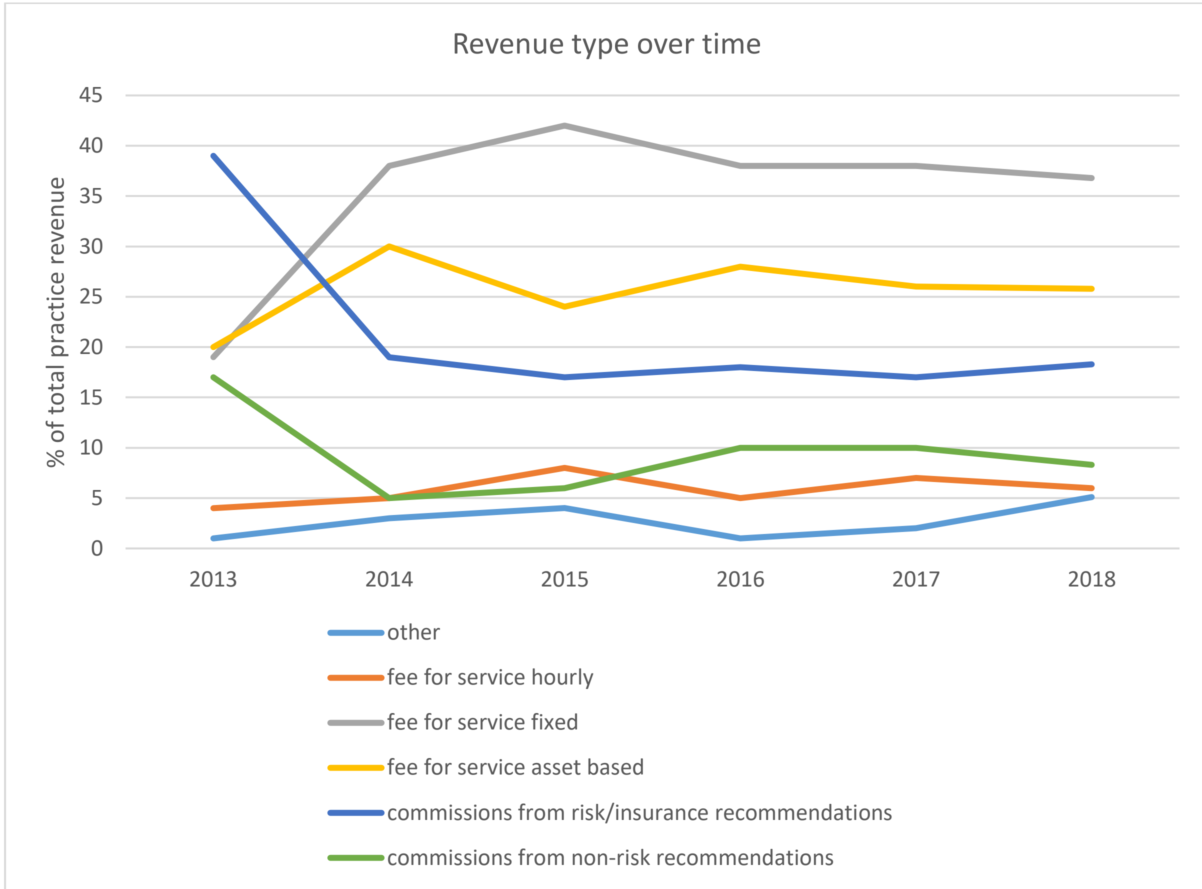
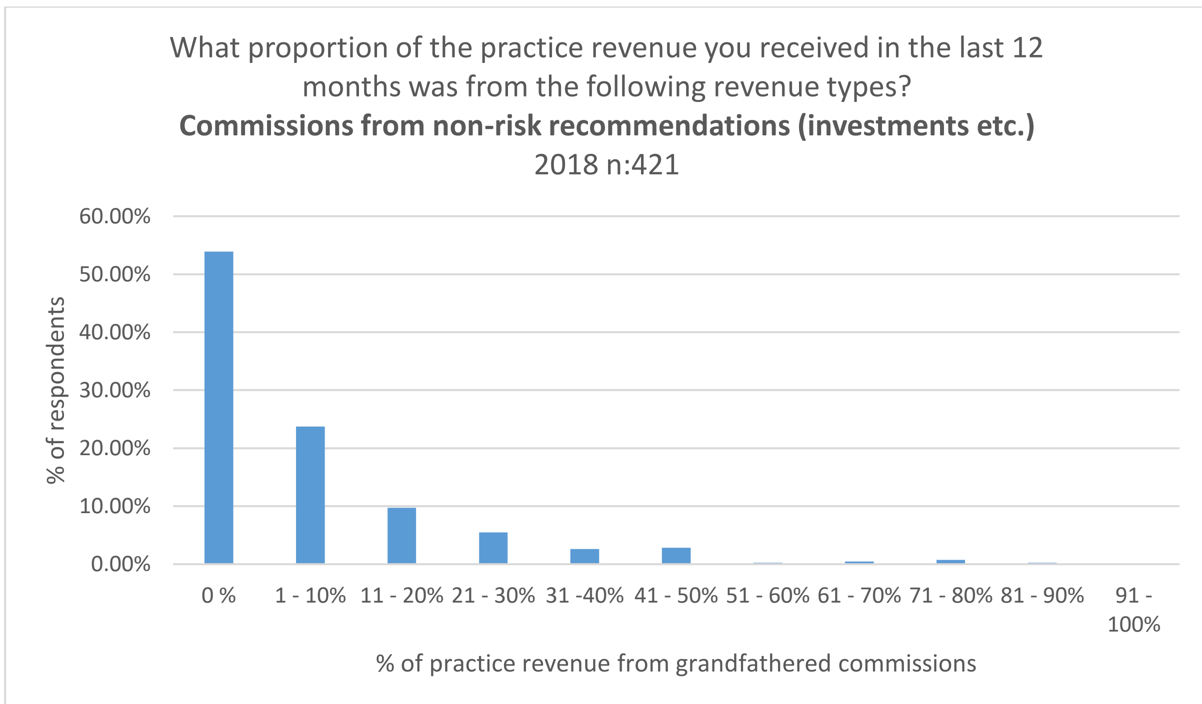

Revenue type over time
% of total practice revenue
45
40
35
30
25
20
15
10
5
0
2013
2014
2015
2016
2017
2018
other
fee for service hourly
fee for service fixed
fee for service asset based
commissions from risk/insurance recommendations
commissions from non-risk recommendations


What proportion of the practice revenue you received in the last 12 months was from the following revenue types?
Commissions from non-risk recommendations (investments etc.)
2018 n:421
% of respondents
60.00%
50.00%
40.00%
30.00%
20.00%
10.00%
0.00%
0 %
1 - 10%
11 - 20%
21 - 30%
31 -40%
41 - 50%
51 - 60%
61 - 70%
71 - 80%
81 - 90%
91 - 100%
% of practice revenue from grandfathered commissions

Consumers must be better off

The FPA supports the phasing-out of grandfathered commissions on investment and superannuation products provided the following principles are met:

1. The change is in the client's best interest – no client will be worse off

The FPA's overarching principle is that no client should be left worse off through ending grandfathered commissions. While there are long-term benefits in moving to a fee-for-service remuneration model, there is also the potential for significant short-term disruption and unintended costs for consumers. The FPA has previously recommended a three-year phasing out period to give advisers and consumers the ability to manage these issues. The FPA further recommends that the Government consider the following issues and create transition arrangements to manage them.

2. Commission payments are actually refunded to clients and not retained by the product provider

The Government's announcement to end grandfathered commissions included a commitment for any previously grandfathered commissions that remain in contracts beyond 1 January 2021 to be rebated to applicable clients where the applicable client can reasonably be identified. The draft legislation released by the Treasury includes an ability to make regulations for this purpose, but no details about the mechanism itself.

The FPA supports this commitment but notes that product providers must bear primary responsibility for the rebating arrangements. The burden of managing rebating arrangements cannot fall on consumers, who do not have a choice in how these arrangements are made, nor on financial advisers, who will already be dealing with a loss of commission revenue and adjustments to their business models. Any additional cost to financial advisers through the rebating process is likely to be passed on to clients in the form of higher advice fees.

It is important that product providers have an obligation to rebate commissions and to appropriately migrate consumers from legacy products to modern, fit-for-purpose products. Treasury will need to carefully design the mechanism to achieve and monitor rebating in order for it to minimise disruption and unnecessary administrative costs. The FPA strongly urges Treasury to consult with the financial services industry over the proposed rebating regulations as soon as possible.

3. Tax relief is provided for any adverse tax consequences (including CGT)

Ending grandfathered commissions has the potential to create unintended tax consequences for consumers, leaving them substantially worse off.

For example, rebated commissions provided to a consumer will be considered taxable income. This additional income may push a consumer into a higher tax bracket. Consumers are likely to use rebated commissions to pay advice fees directly and will be left worse off through a higher tax rate.

Another potential consequence could occur where a consumer is forced to change investment products when one is discontinued as a result of the ending of grandfathered commissions. Changing investment products can result in a capital gains tax event and crystalize a substantial tax liability for the consumer. Again, the consumer will be left worse off.

The FPA recommends that Treasury consider the potential adverse tax consequences that could flow from ending grandfathered commission and make appropriate changes to the tax law to offset these consequences.

4. Centrelink benefits are protected from any adverse Centrelink consequences

Ending grandfathered commissions also has the potential to create unintended social security consequences for consumers.

For example, some consumers currently hold investment products (one example being account-based pension products) from prior to 1 January 2015 which receive favourable treatment under income and asset tests for the aged pension and assessment of aged care fees. Should these products be discontinued due to the Government's decision to end grandfathering of commissions, consumers will be forced to move to alternative products that do not enjoy this favourable treatment. Consumers could then be faced with lower pension payments and higher aged care fees, leaving them substantially worse off.

The FPA recommends that Treasury seek advice from Centrelink on the number of consumers who could be in this situation and consider a mechanism to ensure any favourable treatment is able to be carried over into new investment products.

5. Exit fees be banned in line with the Government's 2018/19 Budget proposal on both super and investment products.

Some legacy investment and superannuation products have significant exit fees that are an obstacle for consumers changing products. Consumers who are forced to change out of these products due to an ending of grandfathered commissions could face losing a substantial portion of their capital.

The FPA supports banning exit fees on all investment and superannuation products as a method of protecting consumers from such a loss. It is important that such a ban covers all financial penalties that a product issuer may impose on a client if they chose to exit a product, regardless of whether they are called "exit fees" or not. There is some variation in how such penalties are constructed and labelled, but their unifying feature is that they are obstacles that inhibit consumers moving from legacy products to more appropriate, modern products.

The FPA supports the Government's ban on exit fees for superannuation products which is due to commence on 1 July 2019.