



22 March 2019

Manager

Financial Services Reform Implementation Taskforce

The Treasury

Via email: FOFAGrandfathering@treasury.gov.au

To the Treasury

RE: Ending grandfathered conflicted remuneration for financial advisers

I write regarding the Treasury's consultation on ending grandfathered conflicted remuneration for financial advisers.

CHOICE's welcomes the proposal to prohibit grandfathered commissions. The Future of Financial Advice (FoFA) reforms were predicated on a clear understanding that commission-based payments led to conflicted advice, i.e. advisers giving advice not in the best interests of their clients. The original intent of grandfathering commissions was to "facilitate a smooth transition to the new regime for industry whilst ensuring the ban on conflicted remuneration commenced as soon as practicable."¹ However, nearly six years have passed since the FoFA reforms. Financial service licensees have systematically endeavored to profit from existing pre-FoFA customers. The current exemption has helped to foster the attitude that advisers are justified in continuing to receive payments without doing any discernible work.

Change will only come from legislating an end to all grandfathered commissions. Industry has had ample time to adjust to a new business model. The Royal Commission has shown that members of industry have sought to prolong the existence of conflicted remuneration by taking steps to evergreen grandfathered commissions rather than remove it entirely. This has led to the creation of legacy clients, where there is no incentive for advisers to shift clients into a better or more suitable product. Turning off these conflicted revenue streams will force advisers to work for future income by offering advice to these clients which meets the best interest test.

Ensuring a fair transition away from legacy products

CHOICE encourages strong regulatory oversight from ASIC in this transition process away from grandfathered advice. This will require close monitoring and review of licensee behaviour to ensure that advisers' conduct is in the best interests of their clients.

¹ Treasury 2018, 'Key reforms in the regulation of financial advice: Background Paper 8'
<https://financialservices.royalcommission.gov.au/publications/Documents/key-reforms-in-the-regulation-of-financial-advice-background-paper-8.pdf>

57 Carrington Road Marrickville NSW 2204

Phone 02 9577 3333 | Fax 02 9577 3377 | Email ausconsumer@choice.com.au | www.choice.com.au

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For the first time, many Australians who have been provided pre-FOFA advice will now be covered under the best interests obligation found in Part 7.7A of the *Corporations Act 2001*. Due to changing financial circumstances, for many the best advice will be to not engage further with a financial adviser. Yet the financial incentive remains for an adviser to sell them products and receive a financial pay-off.

CHOICE acknowledges that the Federal Government has issued a Ministerial Direction requiring ASIC to “undertake an investigation to monitor and report on industry behaviour in the period 1 July 2019 to 1 January 2021”.² We encourage the corporate regulator to focus specifically on the transition away from grandfathered commissions. ASIC needs to be vigilant in monitoring the charging of exit fees from legacy products to ensure that clients are treated in a fair and just manner. We also recommend the monitoring period be extended to 1 July 2021 to ensure compliance with the removal of all grandfathered commissions in the industry.

Ensuring compliance with the law

CHOICE welcomes the proposal to rebate Australians if they continue to be charged grandfathered commissions after 1 January 2021. The advice industry will have ample notice of the need to transition clients away from pre-FoFA advice, so there is no justifiable reason for failing to do so. We note that line 24 of the exposure draft should in all likelihood refer to s1317E(1) rather than s1317E(3), as s1317E(1) contains the table of civil penalty provisions.

This rebate process must be closely monitored by ASIC and should include public reporting on any failure to stop charging grandfathered commissions. ASIC should publicly report offending licensees, the amount each licensee have rebated, as well as the number of clients affected. If a customer is rebated grandfathered commissions, they must be clearly notified that the licensee has breached the law.

CHOICE is also pleased to note that the repeal and substitution of s1528(1) will result in civil and criminal penalties applying in instances where grandfathered commissions are paid after 1 January 2021. As the fees-for-no-service scandal has shown, elements of the advice industry have flagrantly disregarded the law and treated breaches as simply the cost of doing business. Strong penalties will act as an incentive for licensees to shift clients away from pre-FoFA arrangements: it will send a clear message to licensees that to do otherwise is illegal.

The removal of all conflicted remuneration in the advice industry

We know that conflicts - including commissions, asset-based fees or simply a big bank placing pressure on advisers in their network – lead to advisers recommending products that are poor value or even harmful to their clients. We have also known the solution to this problem for

² Frydenberg, J. 2019, “Taking action on Banking, Superannuation & Financial Services Royal Commission. Recommendation 2.4: grandfathered commissions.”

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decades: remove the conflicts. Previous reform, including FoFA went some of the way to address issues. However, more work needs to be done. CHOICE urges the Treasury to review remaining conflicted remuneration and conflicts of interest in the financial advice sector, and ensure they are dealt with once and for all.

One particularly pernicious form of conflicted remuneration is asset-based fees. As part of ongoing service arrangements, consumers are often required to pay asset-based fees which are calculated as a percentage of funds under management. Asset-based fees bear no relationship to the work actually done by the financial adviser or the quality of that work. In many instances, asset-based fees are grandfathered commissions under a new guise of “ongoing service arrangements”.

At every step of the advice process, institutions clip the ticket of their client’s savings. Consumers are hit with an asset-based fee when they engage with an adviser. They are hit with an asset-based fee when they access an investment platform. They are hit with an asset-based fee for each product they invest in on that platform. With vertical integration, consumers can be slugged three separate asset-based fees by the same institution who simultaneously provide the advice, offer the platform, and sell their own financial products. These fees are intentionally obfuscated by vague names such as “adviser service fees”, “platform administration fees” and “investment management fees”.

Asset-based fees unfairly penalise those with more savings. It is very unclear how the service that is provided for an individual who has \$200,000 invested in a platform differs compared to another person with \$100,000 invested, yet the first individual is slugged double to simply access the service.

Asset-based also fees create conflicts of interests that may encourage the adviser to give poor quality advice. They discourage strategic advice such as personal debt reduction, like paying down a home loan or credit card, for which the adviser would not earn a fee, towards recommendations that acquire products in which an adviser can extract an asset-based fee. Once established, asset-based fees do not provide an incentive to provide ongoing services to the client, because the financial adviser is paid regardless. They have consistently been a source of poor consumer outcomes for decades.

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We strongly support the Federal Government's proposal to prohibit grandfathered commissions in financial advice. However, we encourage the Government to initiate a Treasury-led inquiry into remaining forms of conflicted remuneration and conflicts of interest - such as asset-based fees - in the advice industry that continue to cause widespread consumer detriment and harm. This will help guarantee that Australians have access to fair and suitable financial advice.

For further information please contact CHOICE on pveyret@choice.com.au

Yours sincerely,

A handwritten signature in black ink, appearing to read "Patrick Veyret". The signature is fluid and cursive.

Patrick Veyret
Policy and Campaigns Adviser

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