

22 March 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) Bill 2019 (**Exposure Draft**), the purpose of which is to implement the Government's response to recommendation 2.4 of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Commissioner Hayne recommends that grandfathering provisions for conflicted remuneration be repealed as soon as reasonably practicable.¹

The Exposure Draft proposes that the repeal of the provisions should take effect from 1 January 2021.

ISA supports the abolition of grandfathered commissions (and any carveouts to the existing conflicted remuneration regime, including removing the exception for commissions on life risk insurance products). For the reasons set out below, the 1 January 2021 timeframe is excessive, unacceptable and needs to be brought forward to 1 July 2019.

The Future of Financial Advice (**FOFA**) reforms were introduced in response to a series of financial advice scandals in which investors suffered significant losses. At the centre of these scandals was the lack of a legal requirement for financial planners to act in their client's best interests, coupled with conflicted remuneration where commissions and other incentives encouraged planners to recommend certain products. Because of intense lobbying from the banking sector and its representative bodies, payment and receipt of some forms of conflicted remuneration for financial advice is permitted by virtue of grandfathering provisions in the Corporations Act. The effect of this was that trail commissions on products purchased before 1 July 2013 and, upfront and trail commissions on many life insurance products remain.

The rationale for the grandfathered provisions received some attention from Commissioner Hayne, who noted in his Final Report that:

"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

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

*were valid when that exception was introduced, it is now clear they have outlived their validity*². [Emphasis added]

The grandfathered commissions are a lucrative source of income for financial institutions and advisers and this explains why the financial industry, until recently, has been reticent to voluntarily stop charging. 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.

While there are various reports about how much is paid in commissions, the reality is the number is substantial. No matter which figure is accepted, it is material.

The Productivity Commission, in considering the impact that fees have on net returns noted that:

*"... at least 2 per cent of member accounts are still subject to trailing adviser commissions – despite such commissions being banned since 2013 for new accounts by the Future of Financial Advice laws. Eleven retail funds identified in data published by the Royal Commission are estimated to have collected in excess of \$400 million in such trailing commissions in 2017 alone. While largely a legacy problem, these commissions can materially erode member balances"*³. [Emphasis added]

ASIC in considering the value of grandfathered benefits found that:

*"On average, licensees indicated that grandfathered benefits were worth around one-third of their total income (though substantially more or less than the average in some cases). Grandfathered benefits tended to be a greater proportion of the large licensees' revenue streams, on average"*⁴.

It is inexcusable that for an extended period millions of dollars will continue to be funnelled to advisers instead of consumer accounts, where that money could be earning interest and help to provide for their retirement. Where grandfathering (and or exceptions to conflicted remuneration) is in place, it motivates advisers and product issuers to retain that revenue stream at the expense of consumers' best interests. For example, the Royal Commission uncovered that particular financial institutions:

1. unnecessarily delayed the transfer of super to MySuper because the grandfathered commissions would cease⁵; and
2. recommended individual life insurance cover over group life cover, as individual cover allowed for commission flow⁶.

Arguably, such case studies before the Royal Commission would not have occurred if there had been a blanket prohibition on conflicted remuneration (i.e. no grandfathering provisions or carveouts). By allowing grandfathering provisions until 1 January 2021, the government is willing to accept the extension of the period that consumers are exposed to financial harm.

² Ibid.

³ Productivity Commission, Final Report, Superannuation Assessing Efficiency and Competitiveness Inquiry, p 16

⁴ ASIC Report 407, 17 September 2014, p 30.

⁵ Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 2, p 71, 74

⁶ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Transcript, p 5292 line 16

No convincing reason has been provided to justify why delaying the ending of the commissions until 1 January 2021 is appropriate. Considering the material benefit to consumers (i.e. increased retirement benefits) of implementing the changes sooner rather than later, it seems odd that such a lengthy lead time is deemed necessary. In fact, Commissioner Hayne reported that:

“Each of the major banks has already announced steps to reduce or eliminate payments of grandfathered commissions in their financial business.”⁷

Many in the industry have already prepared themselves to remove the grandfathering provisions and those who have not should have prepared, given the warnings that have been given. The 2021 date will unnecessarily disadvantage consumers and it seems the government has underestimated the willingness and adaptability of the industry to move quickly to remove them. For example, we note that:

1. In June 2018, Westpac announced that financial advisers employed by BT Financial Advice would no longer receive grandfathered commissions. Westpac estimated that up to 140,000 client accounts were subject to commissions that would be removed and estimated a resulting \$40.8 million annual reduction in revenues.⁸
2. Macquarie advised it would turn off commissions paid to its private wealth and private advisers, affecting 17,000 clients.⁹
3. CBA advised it would rebate all grandfathered commissions from 1 January 2019 in respect of superannuation and investment products. CBA estimated that this would benefit around 50,000 client accounts by a total of \$20 million annually.
4. NAB announced that customers of its Financial Planning and Direct Advice business would be rebated grandfathered commissions paid by NAB Wealth product providers from 1 January 2019.¹⁰
5. ANZ advised that from 1 April 2019, ANZ Financial Planning would no longer retain grandfathered commissions in relation to the OnePath investment and superannuation platforms, and that clients would receive the amount of the commission by way of a rebate.¹¹

There is no justification for not removing the grandfathering provisions immediately. The 1 January 2021 timeframe is out of step with industry and community expectations. While grandfathered commissions continue, the integrity of the financial industry system remains undermined. There are thousands of consumer accounts being unnecessarily eroded by grandfathered commissions, which frankly have no place in an industry which is required to act in the best interests of members. Now is the time to put consumers before profits and self-interests. The aim should be to have a repeal date at the earliest possible time rather than the latest possible time to ensure maximum benefit to consumers.

ISA has always been and always will be a strong advocate that exemptions for conflicted remuneration should not exist. In a system which has been severely undermined by poor behaviour that has resulted in poor outcomes for consumers, there is no place to sustain a misalignment of incentives that can and does lead to inappropriate advice being provided. ISA encourages the government to end all carveouts in the conflicted remuneration regime as a priority.

⁷ Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, p 183

⁸ Ibid

⁹ Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, p 184

¹⁰ Ibid

¹¹ Ibid

While this consultation does not address the exception for life risk insurance products, general insurance, consumer credit insurance etc, they too require urgent attention. For example, there are instances where the exception for life risk insurance products is being used to circumvent the ban on conflicted remuneration in superannuation. It is not too difficult to imagine the scenario of consumers being sold into “commission” payable insurance arrangements even though they most likely hold insurance through default or group life arrangements. Commissions encourage this type of behaviour. The justification for continuing commissions is not justifiable in light of all the misgivings identified in the Royal Commission.

RECOMMENDATIONS:

1. The grandfathering provisions should be repealed immediately, or no later than 1 July 2019.
2. No carveouts should exist in relation to the banning of conflicted remuneration.

We appreciate the opportunity to comment on the Exposure Draft. Please do not hesitate to contact me with any questions.

Yours faithfully



Litsa Tsitsis

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