AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

26 April 2019

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

Email: FOFAGrandfathering@treasury.gov.au

Dear Sir or Madam

Re: *Exposure Draft Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations* 2019

In brief:
AIST rejects the Government's proposal to allow the payment of grandfathered commissions and other conflicted remuneration under rebate schemes.

AIST seeks a complete ban on the payment of conflicted remuneration, whether that conflicted remuneration can be attributed to a particular client or paid to a client group. This is the only way to ensure that members' best interests are met and that advisers are not tempted to game the system through an ill-defined and difficult to monitor rebate system.

AIST appreciates the opportunity to provide comment on the *Exposure Draft Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Regulations* 2019 (draft Regulations).

AIST rejects the approach proposed in the draft Regulations.

There are four main reasons for AIST rejecting the approach:

1. Continuing to allow grandfathered commissions is not in members' best interests.
2. Commissioner Hayne's concerns would not be addressed.
3. The rebate of commissions approach is subjective and could not be properly monitored by the regulators.
4. Meeting the best business interests of advisers should not be a determining factor.

AIST's recommendations

AIST recommends a complete ban on the payment of conflicted remuneration, whether that conflicted remuneration can be attributed to a particular client or paid to a client group. This is

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the only way to ensure that members' best interests are met and that advisers are not tempted to game the system through an ill-defined and difficult to monitor rebate system.

Such a ban should come into effect as soon as possible. AIST recommends that the ban commence in 2020. No evidence has been given as to why continuing grandfathered commissions in any form is of benefit to consumers.

Not in members' best interest

The Royal Commission heard evidence that five years after the introduction of the Future of Financial Advice reforms, grandfathered conflicted remuneration remains endemic in the retail financial sector. This is why a complete ban on conflicted remuneration is needed – without this, misconduct will continue.

The facts speak for themselves. The adviser industry collects total fees of over $2.9 billion[1] a year from clients. To put this into context, this is approximately 7% of the Government's cost[2] of providing the age pension and other support to pensioners. In 2018, ASIC found that adviser conflicts of interest are not managed – over 68% of clients receiving personal advice invested their money in an in-house product[3]. Recent research demonstrates that members receive less returns for twice the cost, showing how poor some bank owned superannuation products are[4].

Commissioner Haynes' concerns not addressed

Recommendation 2.4 from the Royal Commission is that grandfathering provisions for conflicted remuneration should be repealed as soon as is reasonably practical.

The then Deputy Chair of ASIC Peter Kell gave evidence at the Commission that grandfathering was initially permitted following the introduction of the Future of Financial Advice reforms in 2013, on the understanding that this would be a temporary, transitional arrangement. He stated that 'it was … depicted as a transition issue of a relatively modest or limited nature'.

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[1] Ending Commissions - What It Means For Advisers: Adviser Ratings *https://www.adviserratings.com.au/news/ending-commissions-what-it-means-for-advisers/*

[2] Based upon figures from the 2018-19 Budget for Age Pension and other income support for pensioners of $45.1 billion quoted in Klapdor, M. (2019). Welfare expenditure: an overview. *[online] www.aph.gov.au . Available at: https://tinyurl.com/yy99h8qb [Accessed 25 Apr. 2019].*

[3] ASIC (2018). *Report 562 - Financial advice: Vertically integrated institutions and conflicts of interest*, January 2018. [online] ASIC. Available at: https://tinyurl.com/y8na5dfd [Accessed 8 Mar. 2018].

[4] SuperRatings (2019). *For AIST - Fee and Performance Analysis*. [online] AIST. Available at: https://tinyurl.com/y52dufgx [Accessed 24 Apr. 2019].

Commissioner Hayne noted that grandfathered commissions are conflicted remuneration and there must be a recognition that conflicts of interest and conflicts between duty and member interests should be eliminated rather than 'managed'.

AIST is strongly opposed to the approach taken in the draft Regulations as it enables commissions which would otherwise be paid to be 'managed' by a subjective form of rebating money to clients rather than being banned.

Commission rebate approach is subjective and cannot be properly monitored

Rebate approach is subjective

The Royal Commission recommended that grandfathering of conflicted remuneration be repealed as soon as reasonably practicable (Recommendation 2.4).

While the Bill would repeal the grandfathered conflicted remuneration provisions from 1 January 2021, the Regulations allow product issuers to completely avoid the ban on grandfathering arrangements by setting up a rebate scheme. The effect of the Regulations is to entrench the ongoing payment of grandfathered commissions.

Allowing product issuers to establish rebate schemes cures the mischief that consumers are out of pocket and receive no services in return. However, it entrenches the incentive for advisers to recommend that clients stay in existing, often poor performing and expensive, products.

The proposal will also trigger the establishment of a range of complex arrangements to rebate both commissions paid to individuals and volume-based bonuses measured by funds under management. For example, the Regulations allow product issuers to rebate volume-based conflicted remuneration to clients under arrangements that are 'just and equitable'. This is a subjective test.

Rebate scheme cannot be properly monitored by the regulators

AIST understands and appreciates that the Government has issued a Ministerial Direction requiring that ASIC undertakes an investigation to monitor and report on industry behavior in the period 1 July 2019 to 1 January 2021. While AIST strongly supports such a monitoring system, AIST also strongly believes that ASIC cannot comprehensively monitor the impact of these proposals.

The evidence uncovered at the Royal Commission demonstrated a history within the retail financial services industry of deliberately undermining the regulator's efforts to address problems with fees for no service. Under these proposals, ASIC would be forced to expend significant and scarce resources monitoring these arrangements to ensure that they are fair and where they are not, taking appropriate action, including enforcement action. There is no justification for this, particularly in an environment where ASIC is undertaking multiple investigations in response to referrals of misconduct identified by Commission Hayne.

The Royal Commission heard extensive evidence that advisers frequently recommended that clients staying existing products when it would be in the client's interests to be switched to a better performing, cheaper product. In this regard, AIST notes that neither ASIC nor APRA collects or publishes data regarding the higher cost, often poorer performing Choice or legacy products.

ASIC has admitted that it has no hard data on the extent of grandfathered commissions[4]. Given this, AIST questions how ASIC will assess the extent to which the proposals have had success.

Meeting the best business interests of advisers should not be a determining factor

AIST has seen calls that industry should be given a 'reasonable time frame' to give advisors time to implement the changes. AIST fails to understand why the proposals cannot be implemented earlier.

Given the evidence before the Royal Commission that grandfathered conflicted remuneration causes extensive harm to consumers – and that these commissions are at a huge annual cost – AIST recommends that a 2020 implementation date should be provided.

AIST reiterates its long-term view that grandfathered conflicted remuneration should be banned as soon as practicable.

For further information regarding our submission, please contact Richard Webb, Policy & Regulatory Analyst at 03 8677 3835 or at rwebb@aist.asn.au .

Yours sincerely,

Eva Scheerlinck
Chief Executive Officer

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $1.3 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

[4] ASIC has no hard data on grandfathered commissions | Money Management: https://tinyurl.com/yylpv2xy

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.