21 September 2018

Re. Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Module 5: Superannuation

Dear Sir/Madam,

We welcome the opportunity to make written submissions in response to the closing submissions to Module 5: Superannuation, of the Royal Commission. We have responded to questions raised in the closing submissions that are of particular relevance to financial planning and we have focussed on questions about the need for regulatory reform.

If you have any queries or comments, please do not hesitate to contact me at

Yours sincerely

Dante De Gori CFP®
Chief Executive Officer
Financial Planning Association of Australia[1]

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1 The Financial Planning Association (FPA) has more than 14,000 members and affiliates of whom 11,000 are practising financial planners and 5,720 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Graham McDonald, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 26 member countries and the more than 175,570 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 18 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

FPA submission to:

FASEA

21 September 2018

CONSULTATION QUESTIONS

Royal Commission closing questions from Superannuation round of hearings. Specific questions of interest to FPA members include:

Selling of superannuation

1. Is it appropriate that superannuation be sold through bank branches? Is it reasonable to think that there is any prospect that this is likely to produce an outcome that is in the best interests of consumers?

There are circumstances where it is appropriate for a customer to acquire superannuation through a bank branch, such as where the client specifically requests a particular superannuation product where there is no influence from the bank; or where a financial planner advises the customer to obtain the product. In the former case, the customer's freedom to choose should be respected. In the latter case, the financial planner is bound by obligations to act in the best interests of the client, and with appropriate oversight the planner is likely to act in the best interests of the client.

In our view, given the complexity of superannuation and the difficulty in comparing alternative products or options, there is a real risk that consumers who do not receive advice that is legally required to be in their best interests will not acquire superannuation products that are in their best interests. This is the case regardless of whether the consumer initiates the acquisition of the product or whether it is prompted by a branch staff member.

2. Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient?

In our view, general advice should be renamed to clarify that it is provided in circumstances where none of the customer's objectives, financial situation and needs are or would reasonably be expected to be taken into account. The use of the word 'advice' in this context is misleading.

The FPA recommends that general advice be renamed to improve consumer understanding; and for the term 'advice' to be used to refer only to 'personal advice' that takes into consideration the particular consumer's objectives, financial situations and needs.

General advice could be re-named 'general information' or 'financial product information' and be limited to the provision of factual information or explanations relating to financial products or classes of financial products.

The renamed general advice should be regulated with a warning similar to the existing general advice warning. This warning should make it clear that the information is not financial advice; it is information about a financial product or a class of financial products.

To the extent that the new category of general or financial information covers activities currently classed as general advice, the new category should be regulated in the same way as is presently the case. However, there should be an additional warning that the consumer should seek personal advice from a financial adviser.

Engagement by superannuation funds with Aboriginal and Torres Strait Islander people

3. Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?

In circumstances where a member seeking the early release of superannuation on the basis of severe financial hardship from a provider that does not release benefits on these grounds, the member may be able to transfer their benefits to another fund that does. Transferring superannuation causes inconvenience and stress, and comes at a financial cost, to the member. Rather than requiring a member to transfer their superannuation before accessing it on the basis of severe financial hardship, we believe that superannuation funds who do not currently permit early release of superannuation on the basis of severe financial hardship should do so.

However, we note that it may be appropriate that in very limited circumstances, funds should not be required to release benefits early. For example, funds should not be required to release benefits early if this would preclude a fund from being a Qualified Recognised Overseas Pension Scheme for the purposes of UK legislation – as requiring early release may have significant adverse consequences for individual members not seeking early release.

Relationship between trustees and financial advisers

4. Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?

The payment of ongoing commissions and service fees for which no, or unreasonably little, actual service is provided contravenes the FPA Code of Professional Practice and reasonable community expectations, regardless of whether the commissions and fees are grandfathered. For this reason, the FPA opposes payment of commissions and fees in these circumstances.

To help protect consumers from such payments being made in these circumstances, the FPA would support the removal of grandfathering for ongoing commissions and service fees. Specifically, we recommend that grandfathering of commissions for superannuation and investment advice should be phased out over a 3-year transition period.

Removing grandfathering would:

- remove certain ongoing payments that are not clearly identified by the product provider to the consumer as payments to third parties – this means that if these payments continue they would need be separated out and labelled as third-party payments, which would ensure continual disclosure of their quantum and character;
- require these payments and the associated services to be disclosed on a periodic basis; and
- require the payments to cease after a certain period unless the client opts for the payments to continue

Removing opaqueness, requiring periodic disclosure and terminating ongoing fee arrangements unless the member explicitly authorises them reduces the risk that consumers will pay for no, or unreasonably little, actual service or for services that are otherwise of less value to the consumer than their cost.

Our position is consistent with the principles we established in 2009 for financial planner remuneration, which reflect the importance that remuneration in the financial planning profession is clear, concise, comparable, and more than anything else, is aligned to a service that delivers value. These principles are:

1. Clients must be able to understand the fees they are paying
2. Clients must be able to compare the fees they are paying
3. Clients must be presented with a fee structure that is true to label
4. Clients must be presented with fees that are separated between advice and product
5. Clients must agree the fee with their financial planner and can request that the fee is switched off if no on-going advice is required
6. Clients, rather than product providers, should pay for financial planning services, so as to remove potential for bias.

Further, commissions are by their nature part of a product cost. In most cases the removal of an adviser does not provide any benefit to a consumer as the provider simply retains the amount that would have otherwise been paid to an adviser. For the removal of grandfathering of commissions to have any effect there would also need to be a substantial shift in the way historic products with commissions are treated by product manufacturers to ensure there is no consumer detriment. Where the commission payments stop, there needs to be a requirement that foregone commissions are rebated to the client by the product provider.

As noted above, while the FPA believes that clients, not product providers must pay advice fees, flexibility and choice are important for consumers in deciding how to pay for advice. For this reason, the FPA believes that where the advice is provided in relation to superannuation and therefore complies with the sole purpose test, the member should be able to direct the advice fee to be taken from the member's superannuation account.

The FPA does not support a restriction on access to super where the purpose is to pay for financial advice. The FPA therefore opposes legislation to remove access to super for the purpose of paying ongoing service fees.

The FPA believes however that all advice fees must be transparent, and regularly disclosed to consumers. The FPA therefore also recommends that all fees become disclosable on fee disclosure statements, including the source of the fee to ensure consumers are able to clearly identify the source and implication of all fees paid to their financial advice provider. As per the statutory opt-in provisions, clients should also be able to request that the fee is switched off if no ongoing-advice is required. This will ensure consumers are appropriately protected, but also ensure that there is flexibility in the ability for consumers to pay and receive financial advice from appropriately authorised financial advisers.

We also believe that to cover circumstances where it is in the client's best interest to move out of a commission-paying superannuation product, CGT and social security rollover relief be available to the consumer upon the move. This will spare consumers from immediate adverse CGT consequences and loss of potentially favourable grandfathered social security means testing.

Context

GRANDFATHERED COMMISSIONS

FPA explanation in response to Royal Commission

In May 2018, the FPA was asked to respond to questions posed by the Royal Commission on grandfathered commissions. The following is an edited version of our response:

To what extent does the continued legislative condoning of grandfathered commissions shape and influence the culture and attitudes of financial advice licensees so as to create a disconnect between community expectations as to the charging of fees and the tolerance of licensees for the charging of fees for no or little service?

Should grandfathered commissions cease?

Background

Grandfathered commissions from superannuation and investments are defined as trail and other ongoing commission and volume based payments arising from an 'arrangement', i.e. an agreement that was entered into before 1 July 2013.

Research[2] conducted in May 2017 showed that financial planners derive on average only up to 9% of their total practice revenue from grandfathered commissions (i.e. non-life insurance commissions).

Ongoing fee arrangements where the ongoing advice is not provided contravenes reasonable community expectations, regardless of whether they are technically grandfathered.

Grandfathered commissions have led to an environment where some financial advisers are receiving ongoing commissions and yet providing no services. Ceasing grandfathered commissions and making all ongoing fee arrangements subject to FoFA requirements will result in grandfathered fee arrangements quickly coming to an end where no services are being provided to consumers.

Commissions are by their nature part of a product cost. It is important to note that the product manufacturer pays the commission from their fees, this is not a payment that has been specifically authorised by a client. Clients do not have the power to turn off commissions in a product although they can elect to change financial advisers or simply have no financial adviser. In most cases the removal of an adviser does not provide any benefit to a consumer as the provider simply retains the amount that would have otherwise been paid to an adviser.

For the removal of grandfathered commissions to have any effect there would also need to be a substantial shift in the way historic products with commissions are treated by product manufacturers. With FoFA having commenced five years ago, it is time to review the appropriateness of grandfathered commissions and identify an appropriate means of transitioning these payments to a model that reflects current community standards.

It should be noted, during FoFA the FPA supported the need for grandfathering - we are aware of the issues - however, we also believe for the greater good of the profession we do need to investigate how we can move away from grandfathered commissions in a reasonable timeframe.

The FPA recognises the need for financial advisers to be paid appropriately for services provided. At the same time, the FPA Code of Professional Practice is clear that ongoing service should be provided for ongoing remuneration.

The time has come for the removal of grandfathering arrangements that exempt some payment arrangements from this ongoing service requirement. To be clear, the FPA is comfortable for these payment methods to continue but only with the informed consent of clients, by way of the FoFA requirements.

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[2] Investment Trends May 2017 Planner Business Model Report

Where the commission payments stop there needs to be a requirement for the foregone commissions to be rebated to the client by the product provider.

FPA's policy position

The FPA recommends to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry that grandfathered commissions on superannuation and investments should be subject to FoFA provisions after a three year transition period.

This would allow those with grandfathered commission arrangements to continue to receive those payments after three years if the FoFA requirements are met. Those advisers not providing ongoing advice would no longer receive grandfathered commissions, and product providers would be required to rebate unpaid commissions to those clients not receiving advice after the three year transition period.

The FPA has recommended that life insurance commissions not be changed at this point. Life insurance arrangements were recently reviewed and major changes are being implemented through the Life Insurance Framework with a review scheduled for three years' time. The FPA does not believe another review of these arrangements is appropriate now and urges the government to allow the agreed time frame to run before further reviews of life insurance commission arrangements are conducted.

FPA principles

The FPA supports the phasing out of grandfathered commissions provided the following principles are met:

1. The change is in the client's best interest – no client will be worse off
2. Commission payments are actually refunded to clients and not retained by the product provider
3. Tax relief is provided for any adverse tax consequences (including CGT)
4. Centrelink benefits are protected from any adverse Centrelink consequences
5. Exit fees be banned in line with the Government's 2018/19 Budget proposal on both super and investment products.

5. Are there possible detrimental effects on the provision of high quality financial advice by such changes? If it is said that there are such detrimental effects, then the detriments and the reasons for the detriments should be precisely identified. For example, if it is said that it is unlikely that consumers will be willing to pay for the true value of financial advice then, amongst other things, it ought to be explained how the "true value" of financial advice is to be determined, why consumers will pay for the true value of other services but not for financial advice and why it is not sufficient to allow consumers to make an informed choice as to the specific price that is to be paid for a specific service.

The removal of commissions may be detrimental to some clients. For example, certain legacy superannuation income streams that pay commissions receive potentially favourable social security means testing. It may be very difficult to remove the cost of commissions from the pricing of these products. If grandfathering of commissions is ended, the benefit of the commission is unlikely – without legislative intervention - to be passed back to the client and certain clients will lose social security benefits if they move to another product. Such clients are faced with either keeping their current product and paying an advice fee without any financial compensation; or losing social security

benefits if they move to a product that has lower in-built costs to the consumer. For this reason, where the commission payments stop there needs to be a requirement for the foregone commissions to be rebated to the client by the product provider.

Similarly, there may be detrimental CGT consequences for members of certain legacy superannuation products if grandfathered commissions end. Without legislative intervention, these products are likely to retain the benefit of provisions for commissions rather than passing the benefit to the member. Advised consumers then face having to pay additional fees for advice or moving to another product with lower inbuilt fees. However, the latter option may have detrimental CGT consequences where the fund has accumulation interests.

Managing conflicts

6. Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties? For example, where a trustee is a dual-regulated entity, that would seem to raise an inherent conflict of interest, or the potential of a conflict of interest. Are there other structures such as investment of funds in insurance policies issued by related party insurers or the integration of a superannuation trustee into an advice business that also raise inherent problems? Is it possible to say that these conflicts are ever manageable?

Investment of funds in insurance policies issued by related party insurers raises an inherent conflict of interest, as does integration of a superannuation trustee into an advice business. In the former case, there is an incentive for the group of entities of which the fund and insurer are a part to invest in the policies issued by the insurer – regardless of whether the fund can also invest in the products of related insurers. However, it is possible that the related party policy will be appropriate for at least some members of the fund.

Arguably, all conflicts of interests are manageable. The real question is whether the costs, including the risks, of a particular arrangement are assessed as outweighing the benefits. In our view, the benefits of investment in insurance policies issued by related party insurers can outweigh the costs where the conflict of interest is managed by ensuring that the trustee and investment function are separate from the insurance business. In particular, the insurance businesses should be interacted with as though at arms-length and this requirement should be backed by external pressure (such as the force of law) that will ensure compliance.

Integration of a superannuation trustee into an advice business also raises an inherent conflict of interest. There is an incentive for the advice business to charge the superannuation trustee for services regardless of whether the service is in the best interests of any member or group of members, or the members as a whole. However, again, it is possible that integration of a superannuation trustee into an advice business provides benefits (such as consumers having ready access to advice and to advisers who know the systems and procedures of the fund) to at least some members of the fund.

In our view, as with investing in policies of related party insurers, the conflict of interest arising from integration of a superannuation trustee into an advice business should be managed by ensuring the trustee function is separate from the advice function. In particular, the trustee and advice business should only interact with each other as though they are at arms length and this requirement should be backed by external pressure (such as the force of law) that will ensure compliance.