Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into disclosure of commissions on risk products

Submission No. 45

Submittor:

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Attachments? No Attachments

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FPA
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The Secretary,
Parliamentary Joint Committee on
Corporations and Financial Services,
Room SG.64,
Parliament House,
CANBERRA ACT 2600

Attention Senator Grant Chapman

Dear Senator Chapman

INQUIRY INTO THE DISCLOSURE OF COMMISSIONS ON RISK PRODUCTS.

Financial markets cannot work well unless participants act with integrity and there is adequate disclosure to facilitate informed judgements.

Wallis report

The Financial Planning Association of Australia (FPA), Investment and Financial Services Association (IFSA), and Australian Compliance Institute (ACI), welcome the opportunity to provide this joint submission to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Disclosure of Commissions on Risk Products.

The FPA is the peak professional organisation for the financial planning industry in Australia. With over 14,000 members through a network of 31 Chapters across Australia, and a state office in each capital city, the FPA represents the majority of qualified financial planners and their principal licensed dealers. FPA members advise on and/or manage the financial affairs of over 5 million Australians with an investment value of $560 billion.

IFSA is a national not-for-profit organization, representing the retail and wholesale funds management and life insurance industries. IFSA's 100 members are responsible for investing approximately $670 billion on behalf of over nine million Australians.

The ACI is the peak professional organisation representing compliance professionals from all industries, including the financial services sector, in Australia. With around 1000 individual members the ACI, with its members, have a key strategic role to play in ensuring compliance with the law and principles of the Corporations Act.

The combined FPA and IFSA membership represents, we believe, a large percentage of the intermediary, funds management and life insurance community in terms of funds under management and insurance premiums. This submission therefore represents the collective views of financial service providers on the issue of disclosure on all financial products including risk only products.

Position on Risk Commission Disclosure:

We collectively take the view, as we have consistently, that disclosure to retail customers of all commissions, fees, incentives, soft dollar arrangements and bonuses are important to meet the original objectives of 'Wallis'. A retail consumer ought to be in a position to make an informed judgement about the potential influence or bias which might impact on the recommendation to the consumer.

We believe that a consumer should have confidence that the adviser is acting in their interests and is not motivated by hidden rewards and incentives. Secret commissions and benefits undermine the integrity of the client/adviser relationship. This is particularly critical where the client is heavily dependent on the soundness of advice on a complicated product range.

While a commission for example is in essence the same as a fee charged by the provider, which the client is informed about, it is in reality a more convenient method for a consumer to pay for goods and services. Commissions, as a method for the payment of goods and services, have existed in our society for centuries. When viewed in the context of being a convenient method for the consumer to pay for the service then it is only logical that, as with fees, commissions ought to be transparent to the retail consumer.

The provision of disclosure, in dollar terms where possible, is important to ensure that retail consumers have adequate information to base their decisions on and are treated fairly and markets are free from misleading and manipulative or abusive conduct.

International Trends in Disclosure

We repeatedly hear that the Australian model of Financial Services reform as enacted in 2001 is a model that is being viewed as a blue print for reform by overseas regulators.

The most recent example is in the United Kingdom where the Financial Services Authority (FSA) has been conducting a review of its 'Polarisation' policy.

One of the issues examined was the relationship between product issuers and intermediaries and the potential for bias. The FSA released proposed changes to its 'Conduct of Business' rules in December 2002 with a new policy proposal (CP166) in January 2003. One disclosure principle remains constant that is, COB 6.5.38 R which requires the disclosure of "the amount or value in cash terms of commission or remuneration" for, among other products, life policies.

We are aware that the FSA has consulted with both Australian regulatory authorities and industry participants when forming its policy. This clearly is an endorsement that the Corporations Act as it stands is appropriate and in accord with worldwide trends.

Reasons against providing an exemption on risk products

Some participants have asserted that consumers do not need disclosure of commissions on risk products since commissions have no affect on the outcome or value of the product. Hence, it is not important in their decision making.

Is this an appropriate exemption?

We believe NO exemption should be provided for a number of reasons:

a) Exemption 'undermines the level playing' field for other financial products which require disclosure of the quantum of commissions paid to licensees and their representatives. This is especially pertinent when both risk and investment products are delivered under the one 'financial advice' umbrella.

b) Non disclosure of commission on risk products which are bundled together with investment products has the potential to generate an overall distortion on the returns. This might be done by loading up commissions on the risk product and hence artificially enhancing the returns on the investment product.

c) Weakens the universal approach of progressively staged disclosure which culminates in the Statement of Advice. Weakening the level of disclosure of commissions on risk products may have the unintended affect of re-introducing influence and conflicts of interest into the advisory process.

What is the value of advice?

In its recent report on *the regulations and ASIC Policy Statements Made Under the FSRA*, the PJC found that "cost and service, not commission were the primary influences on consumers of risk products". This is based on the level of knowledge that some consumers may have on what constitutes 'cost'. However the 'cost' also includes the commission component and unless the consumer is aware of this 'cost construction', how can they be expected to understand how the adviser might be influenced by this cost component.

Consumers seeking advice from a financial adviser or insurance broker may or may not be cognisant that product issuer and intermediary both charge for their service. Having said that most consumers would expect to pay a professional fee for a professional service. Whether that is a fee paid by the consumer to the intermediary or the product issuer to the intermediary is somewhat academic. They should however, in our view, be aware of how much that fee is.

The cost of advice should be distinguished and separated out from the cost of the product. The fee or commission is the cost of the advice paid for by different methods. It is a distortion to pretend that the advice is free when it has a distinct value separate to the product.

Provision of advice is based on careful consideration of a client's needs, objectives and financial circumstances. Commissions (or fee for service) paid to intermediaries represent the cost to the consumer of obtaining such qualified and professional advice. For example the FPA *Guideline No. 3* states since May 1997.

> "Financial advisors are entitled to receive appropriate remuneration for their professional services. Business and professional clients appreciate the costs associated with delivering a quality advisory service and are normally comfortable with commission arrangements. Some clients may need further explanation about the total costs of providing financial planning services and the fact that gross commission is not profit to the financial adviser."

This is a commonly shared view.

In reality many intermediaries have been obliged to disclose commissions on all products for quite some considerable time. For example insurance brokers have been required since the introduction of the Insurance (Agents & Brokers) Act to advise clients on request full details of commissions paid by underwriters. Financial Planners being members of the FPA have been required to disclose all benefits and commissions on all products including risk insurance in terms of the association's Professional Standards and the aforementioned Guideline #3.

Some proponents have argued "that for trauma or income protection insurance, the clients' premium and end benefit would be the same regardless of the commission paid". We would challenge this view. A consumer is likely to receive various quotes on such risk insurance products, depending on both the product recommended and the intermediary. In such circumstances, it would be difficult for a consumer to discern whether the variation is based in the product design and/or the level of commission on offer to the advisor for their services.

Additionally many advisers also receive other benefits such as attendance at company sponsored conventions, bonuses for volumes of sales and other benefits clearly intended to influence the promotion of one product over another. Any assertion that this practice no longer exists is wrong. There is nothing inherently wrong in a product manufacturer trying to promote its product over another and in fact successive governments have legislated to ensure healthy competition exists in Australia. We just believe it must be disclosed. These components are logically factored in by the product manufacturer to the price of the product. While the end benefit could be the same the recommendation could be influenced by commission structure and incentives, which are in them selves major factors in the cost of the premium.

Disclosure of commissions would allow the consumer to make a fair comparison between the price of the product, features and benefits and the potential bias towards each particular product. Comparability was a key objective of Wallis.

Cost/benefit of disclosure of risk commissions.

I. **Cost:** The cost of disclosing commissions on risk products is insignificant in our view as it will merely entail the insertion generally of standard details in the Financial Services Guide. The disclosure in the Statement of Advice is not a new concept. Many intermediaries already disclose all commissions and benefits in relation to financial products either automatically in financial plans or on request in the case of insurance brokers.

II. **Benefits:** We do not agree with the previous findings of the PJC that "a disclosure requirement for risk products would be particularly detrimental to small business operators". Some industry participants assert that small dealerships are at a disadvantage at having to disclose the commissions they receive for risk insurance products relative to large dealer groups which are not required to disclose 'margins' or risk commission on products sold as they operate under a salary as well as performance incentives schemes.

    The FPA believes this is an inaccurate comparison. A more legitimate comparison is of small businesses operating under the varying disclosure regimes prior to the FSRA taking affect.

    At the previous PJC inquiry and public hearings, the FPA argued that existing financial planning advisory firms acting as agents of Securities licensees in general have a higher sale value (4 to 5 times commission income) compared to risk insurance agency firms (2 to 3 times commission income) operating as agents of insurers. With that in mind we do not believe that the FSRA disclosure regime has had any adverse impact on small businesses. To the contrary, we believe that a small business operating under the FSRA disclosure regime would have an enhanced value as demonstrated above.

Conclusion:

The disclosure of all commissions and other benefits, direct or indirect, will enhance consumer protection and empowerment which inturn generates greater consumer confidence. Consumer confidence in the financial services industry will have a positive affect on the value of both licensees and their representatives operating as small businesses.

All participants in this submission have consistently supported the principles underpinning the FSRA. It is for this reason that we believe that disclosure of commissions on risk products are essential if the principles of transparency as envisaged in 'Wallis' are to be met.

For the FPA	For IFSA	For the ACI
Ken Breakspear	Richard Gilbert	Mike Lotzof