Chapter Nine

Commission-based selling

Introduction

9.1 This chapter examines two issues:

a) Commission-based selling, and concerns that the portability regulations could lead to increased churning of accounts to the benefit of financial planners; and

b) The impact of the portability regulation on not-for-profit funds.

Commission-based selling

9.2 It its September 2002 consultation paper, Treasury noted that 'Portability would increase the importance of financial advisers in the selling of superannuation'. A number or parties raised issues relating to financial advisers and commission-based selling during the inquiry.

9.3 In its written submission, AAS argued that many financial planners are reluctant to recommend non-profit superannuation funds, such as industry funds, which do not pay commissions. In support of this argument, AAS cited the findings of the recent ASIC/ACA Survey on the Quality of Financial Advice Planning. AAS cited the following passages from the report:

> A common observation by several judges was that clients' interests did not appear to be the sole factor in the plan strategy or product selection. … Recommendations frequently overlooked options that may be more cost-effective … low cost superannuation funds – never recommended; …
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> Many plans did not recommend the lowest cost option available. As low cost options pay no commission, this raised some suspicions about the influence of commission on advice. For example, no adviser recommended switching to a non-profit, industry superannuation fund.[1]

9.4 Similarly, the ACA[2] and the Corporate Superannuation Association also referred to the ASIC/ACA Survey on the Quality of Financial Advice Planning. The Corporate Superannuation Association commented:

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1 *Submission* 18, AAS, p. 6.

2 *Submission* 32, ACA, p. 4.

> The ACA's findings suggested that a significant number of planners involved in the survey did not take sufficient account of their clients' needs and objectives and made investment recommendations without apparent justification (seemingly to earn the planner commissions).[3]

9.5 The Committee also notes the evidence of Ms Galbraith from Superpartners in regard to the ASIC/ACA report. Ms Galbraith indicated that 48 per cent of people surveyed who preferred commission-based advice as opposed to up-front fees thought it would motivate the adviser to give better advice. They did not appreciate that the commission was based on the initial placement and ongoing capital inflows, regardless of how well or badly the investment performed.[4]

9.6 Given these concerns in relation to commission-based selling, the Corporate Superannuation Association argued that the introduction of the portability regulations could increase the likelihood of fund members being persuaded by financial advisers to move their savings around either once or repeatedly, the principal advantage of which would accrue to the advisers in the form of commissions (to the detriment of individuals).[5] This was reiterated by Mr Brookes from the Corporate Superannuation Association in the hearing on 1 August 2003:

> Our real concern with portability and choice of fund is that the mechanisms at the moment are corrupt. They are corrupted by self-interest, generally, in the advice being given, which is profit driven.[6]

9.7 Similarly, Dr Anderson from ASFA stated in the hearing on 31 July 2003:

> In a portability regime, as in a choice regime, uninformed consumers would be vulnerable to unscrupulous people interested in their own wealth creation, not the client's.[7]

9.8 In response to this issue, the Committee notes that in their written submissions, AIST[8], IFF[9] and Cbus[10] all recommended a ban on commission-based roll overs/transfers of <u>mandated</u> employer superannuation contributions. The MTAA Super advocated a ban on commission-based selling of superannuation products where

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3 *Submission* 9, Corporate Super Association, p. 4.

4 *Committee Hansard*, 1 August 2003, p. 16.

5 *Submission* 9, Corporate Super Association, p. 4.

6 *Committee Hansard*, 1 August 2003, p. 36.

7 *Committee Hansard*, 31 July 2003, p. 14.

8 *Submission* 11, AIST, p. 2.

9 *Submission* 4, IFF, p. 4.

10 *Submission* 16, Cbus, pp. 2,3.

the taking of that product would lead to higher management fees or charges than in the member's current fund. In effect, this would be a 'no detriment test'.[11]

9.9 Support for a ban on commission-based roll overs/transfers of mandated employer superannuation contributions was reiterated in hearings by Mr Watson from MTAA Super,[12] Mr Silk from IFF and Ms Hewett from Cbus. Ms Hewett stated in the hearing on 1 August 2003:

> We understand that there are about 15,000 financial advisers in Australia and most of those are remunerated with some configuration that includes a commission base. … We think that financial planners can play a very constructive and very positive role if there is no conflict of interest, but our experience, again, has shown that very often there is a conflict of interest between getting a good retirement outcome for the member and making sure that the financial planner's remuneration is maintained. We see this as a problem in a commission based environment, and we think that commissions should not apply to mandatory contributions.[13]

9.10 Similarly, Mr Silk from IFF stated in the hearing on 1 August 2003:

> But, more fundamentally, we submit, as I have indicated in our written submission and also have said today, that there should not be commissions—which is the major issue at play in terms of contracts—on mandated employer contributions. If the federal parliament dictates that employers should pay nine per cent of an employee's wage or salary into a superannuation account then we say it is entirely inappropriate for third parties to excessively enrich themselves at the expense of the intended beneficiary of those payments.[14]

9.11 Although not advocating a ban on commission-based selling, in its written submission, Taxpayers Australia advocated that the regulators will need to be vigilant regarding possible churning of accounts and inappropriate recommendations from financial advisers.[15]

9.12 In response to some of these concerns, Mr Hristodoulidis noted that Section 947D of the new FSR Act makes it clear that the Government will not tolerate churning of fund members by financial advisers. Mr Hristodoulidis also cited the recently released ASIC policy statement No. 175, entitled 'Licensing: financial product advisers—conduct and disclosure', paragraph 175.91 of which states:

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11 *Submission* 6, MTAA Super, p. 6.

12 *Committee Hansard*, 31 July 2003, pp. 6-7.

13 *Committee Hansard*, 1 August 2003, p. 20.

14 *Committee Hansard*, 1 August 2003, p. 6.

15 *Submission* 23, Taxpayers Australia, p. 2.

> In the case of advice to replace one product with another product or to switch between investment options within a product, [ASIC] consider that the advice will generally be inappropriate if the providing entity knew or ought reasonably to have known that the overall benefits likely to result from the new product or option would be lower than under the old product or option. This applies where either or both the new product or the old product is a financial product for the purposes of part 7.7. Of course, [ASIC] would be unlikely to reach this view where there are overall cost savings to the client that are likely to override the loss of benefits. The determination of whether there are overall cost savings for the client must take into account all the circumstances, including the costs of the replacement i.e. making the switch.[16]

9.13 The FPA also indicated in its written submission that it has recently launched a national strategy called the Professional Partner Program aimed at 'raising the bar' in relation to professional standards in the financial planning community. The program will include five campaigns which will target disclosure, professionalism, advice, the FSR Act transition and consumer issues.

9.14 In launching the first campaign on disclosure, the FPA has established an industry taskforce to review disclosure issues in the Australian financial planning industry, including remuneration and benefits. The taskforce will make recommendations to the FPA Board of Directors on improvements to the principles and practices of disclosure of adviser remuneration and other benefits as well as factors likely to influence advisers in the provision of advice.[17]

9.15 The Committee notes that these matters were reiterated by Mr Hristodoulidis from the FPA in the hearing on 31 July 2003.

> …the success of the professional partner program relies on acceptance by all stakeholders. To this end, the program was developed in consultation with our members and other key stakeholders. We surveyed our members on the final program and found very strong support. Over 90 per cent of members either strongly or very strongly endorsed the program. Under the FPA's professional partner reform program, the FPA has today announced a major initiative in the drive for greater professionalism. We are committed to promoting the CFP designation as the mark of distinction of a professional financial planner and the highest membership designation bestowed on individuals who meet the high standards of education, examination, experience and ethics. The CFP is the highest internationally recognised designation for financial planners in Australia. There are already 5,000 CFPs practising in Australia, and it is expected that this number will

16 Cited in *Committee Hansard*, 31 July 2003, p. 61.

17 *Submission* 24, FPA, p. 4.

> continue to rise, with more than 800 students having enrolled in the CFP program each semester in the last 12 months.[18]

9.16 Finally, the Committee notes that in its written submission, APRA indicated that it would be concerned if implementation of the portability regulations led to commercially driven interests placing pressure on uninformed superannuation fund members to move their super where this would not be in their best interests. Accordingly, APRA supported the measures that the Government has previously outlined in relation to an education program as well as disclosure requirement under the FSR Act.[19]

Not-for-profit funds

9.17 Following on from the concerns raised above in relation to commission-based selling, the Corporate Super Association argued that the portability regulations would promote a one-way flow of funds out of not-for-profit employer-sponsored superannuation funds into retail funds.[20]

9.18 The basis of this concern expressed by the Corporate Super Association was that retail funds can promote themselves to the public and invite members. Not-for-profit funds, on the other hand, by their nature are established and operate under an arrangement between the trustee and the employer-sponsor and do not seek roll overs/transfers from the general public.

9.19 The Association further suggested that given the ongoing fees paid by members of retail funds and additional costs of moving funds, a one-way flow of funds out of not-for-profit employer-sponsored superannuation funds would result in lower overall retirement savings for Australians.[21]

9.20 This issue was reiterated by Mr Brookes from the Corporate Super Association in the hearing on 1 August 2003:

> The signs are there, and it is happening already, whereby the financial conglomerates occupy the key positions around which portability and choice of fund govern the field. To counter that, to have balance, we should have a position where the not-for-profit sector is not eliminated and is not obliged to be for-profit as the only way to survive. The not-for-profit sector itself can give generic advice, dispassionately and disinterestedly, to its members. That to us is the key issue. If we do not cross that bridge, it will be the end

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18 *Committee Hansard*, 31 July 2003, p. 61.

19 *Submission* 14, APRA, p. 5.

20 *Submission* 9, Corporate Super Association, p. 6.

21 *Submission* 9, Corporate Super Association, p. 6.

> of the not-for-profit provision of super and the end of the best deal for Australians.[22]

9.21 In its written submission, AAS also raised the issue of not-for-profit funds. AAS indicated that the majority of its clients are industry funds which charge fees at a level to recoup costs. As such, they have less resources for marketing compared to large, retail providers.

9.22 Accordingly, AAS argued that retail funds with large marketing budgets would be the greatest beneficiaries of the portability regulations, with non-profit funds potentially the largest losers.[23] Again, this was reiterated by Mr Korchinski from AAS in the hearing on 31 July:

> … we have concerns that members may be severely disadvantaged, because retail superannuation providers with large marketing budgets would be the greatest beneficiaries of a portability regime and the members of non-profit funds would potentially be the largest losers. Many financial planners are reluctant to recommend non-profit superannuation funds, such as industry funds, which do not pay commissions.[24]

9.23 Finally, the Committee also notes the evidence of Capt. Woods from SOS in the hearing on 31 July 2003. He argued that with the drive towards portability and choice, corporate funds are going to be faced in the not too distant future with the option of either competing in the market place or outsourcing their superannuation obligations. Prior to that happening, Capt. Woods argued that the representative industrial association should be given an opportunity to negotiate with the large corporate funds in order to allow those funds and their representative bodies to build new industry funds that provide economies of scale.[25]

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22 *Committee Hansard*, 1 August 2003. p. 37.

23 *Submission* 18, AAS, pp. 5-6.

24 *Committee Hansard*, 31 July 2003, p. 52.

25 *Committee Hansard*, 31 July 2003, p. 67.