Submission

to

Parliamentary Joint Committee on Corporations and Financial Services
Inquiry into Financial Products and Services in Australia

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Volume over-rides. Volume Bonus. Profit Share. Platform rebates.

These are all the same thing with a range of different names.
Clearly, volume over-rides are just commission by another name.
If commissions are to be banned – then volume over-rides need to be banned.
Volume over-rides are commonly not disclosed – offenders need to be prosecuted.

Survey by Money Management magazine during the week of 10th June 2009 had the following result. Overwhelmingly, financial planners believe that volume bonuses (volume over-rides) are simply commission by another name. How can FPA sustain calling for a ban on commissions – while supporting continuation of volume over-rides?

Polls

Do you believe volume bonuses paid by product manufacturers to dealer groups should be subject to the same scrutiny as planner commissions?

Of course, they go towards influencing approved product lists.

35%

Yes, they are just a commission by another name.

56%

No, they simply represent a discretionary bonus.

9%

Table of Contents:

1. Volume Over-rides are commission by another name – and should be banned.
2. Disclosure of volume over-rides. Those not disclosing volume over-rides should be prosecuted.
3. The FPA's position on volume over-rides is inconsistent and unsustainable.

Appendix A. Money Management 11/6/09 - “Licensee volume bonuses not on FPA's agenda”.
Appendix B. Different ways that Volume Bonuses are paid.
Appendix C. How volume over-rides fit into the overall distribution systems.
Appendix D. the UK Financial Services Authority Bans Commissions.
Appendix E. Key excerpts from UK FSA's “Distribution of retail investments” report June 2009.
Appendix F. CPA Web site - “Fingers in the Pie”.

Attachments:

- Asset Magazine 1/6/09 article “No easy answer on commissions”.

“Wrap fees are disclosed in so many different documents it would take a forensic accountant to work out who gets what.” Pru Moodie in “Fingers in the Pie” CPA web site. What chance does an investor have of getting clear, concise and effective disclosure of fees?
(http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-541CAE0F/cpa/hs.xsl/724_24883_ENA_HTML.htm)

“I don’t think I could get up here and explain super fees to you; let alone a lay audience. Where would I start? How could I explain the web of charges and commissions, splits between players, volume and other sorts of rebates, shelf fees, contribution fees, exit fees, asset level versus account level, buy/sell spreads and maybe even arrangements I don't yet know about? Surely, nobody could follow it without studying a diagram, unless, of course, they have been living with it for years.”
Jeremy Cooper 18/6/09 presentation to ASFA.

Under Corporations Law, CLEAR CONCISE and EFFECTIVE disclosure is required. Clearly this is failing give the complexity of financial arrangements that Jeremy Cooper is describing.

What does this June 2009 consultation paper “Distribution of retail investments: Delivering the Retail Distribution Review” (http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf) **mean for financial planning AFSLs?** Superficially, the UK FSA's consultation paper seems to mean, in Australian terms:-

- A ban of a financial planning firm profiting by wholesaling a product and putting a mark-up on that product before badging and selling that product. This covers situations such as financial planning AFSLs badging or white-labelling the BTWrap platform, which is a common practice. This conclusion is drawn from the UK FSA document Section 4.15.
- A ban on a financial planning firm receiving volume over-rides. This conclusion is drawn from the UK FSA document Section 4.68 and 4.14.

The same correct rationale that the UK Financial Services Authority is using:
- to ban volume over-rides and
- to ban financial planning AFSLs from profiting by white-labelling and badging other products

should also be applied to Australian financial services regulations for the same reasons – namely to ensure that the consumer will be better off.

1. Volume Over-rides are commission by another name – and should be banned.

There are a wide range of financial payments that occur from financial product manufacturers to financial planning Australian Financial Service Licensees (AFSL). One of the most contentious payments are volume over-rides (also called profit shares, volume bonuses, platform rebates.)

Volume over-rides are commissions by another name, but often are not disclosed to consumers.

Let us examine the parallels between volume over-rides and trailing commissions:

- Trailing commissions are paid to financial planning AFSLs.
  - NOTE: Commissions are not paid to advisors.
- Volume over-rides, like trailing commissions are paid to financial planning AFSLs.
- Trailing commissions increase as more product is sold. Trailing commissions create an incentive to sell more product.
- Volume over-rides increase as more product is sold. Volume over-rides create an incentive to sell more product.
- Fund managers can pay higher trailing commissions on funds which have higher managements fees (MERs). Trailing commissions can increase the cost to Australian consumers of managing their superannuation and managing their non-superannuation investments.
- Fund managers can pay higher volume over-rides on funds which have higher managements fees (MERs). Volume over-rides can increase the cost to Australian consumers of managing their superannuation and managing their non-superannuation investments.
- Trailing commissions are part of a system of non-price competition that occurs between fund managers in Australia – reducing price competition in Australia – increasing the cost to consumers. See supplementary submission number 4 for greater discussion on the system of non-price competition.
- Volume over-rides are part of a system of non-price competition that occurs between fund managers in Australia – reducing price competition in Australia – increasing the cost to consumers. See supplementary submission number 4 for greater discussion on the system of non-price competition.

Financial planning AFSLs can use income from any and all sources to incentivise their planners to deliver the outcomes and profit objectives desired by the financial planning AFSL.

In summary:

- Both volume over-rides and trailing commissions are payments from fund managers to financial planning AFSLs.
- Volume over-rides and trailing commission are virtually identical in terms of why they are paid, how they are paid and to whom.
- Therefore volume over-rides have precisely the same potential to taint advice as trailing commissions do.
- The only difference between volume over-rides and trailing commissions is that volume over-rides are easier to hide from the consumer and to not disclose.

Note: In their **June 2009 consultation paper "Distribution of retail investments: Delivering the Retail Distribution Review", the UK Financial Services Authority** is proposing:

- "**Adviser Charging: what it means for product providers**
  4.14 To end the system of product providers offering amounts of commission to adviser firms, we are proposing new responsibilities on product providers, as well as on adviser firms. Just as the rules we are consulting on would prevent adviser firms from receiving commissions set by product providers, we are also consulting on a ban on product providers offering commissions (or other payments or benefits) in relation

to advice on investments given to retail clients.

4.15 This requirement is not designed to prevent product providers from offering different product prices through different distribution channels (for example, a large IFA network might be able to secure a product with a lower product charge than a sole trader). In order for the market to operate competitively, we are content that different product prices will continue to be available through different channels, but where firms access lower prices they will have to pass these on completely to their consumers, without retaining a margin."

- **"Regulating platforms and their charges**
  4.68 In drafting the rules contained in Appendix A, we have taken every effort to ensure that adviser firms will not be able to continue to receive commissions, profit shares or other remuneration determined by product providers and other third parties. At the same time, we have begun to receive questions from the industry about the acceptability of other firms, such as fund supermarkets, continuing to receive commission set by product providers. These, in turn, lead to wider questions about the best way to achieve transparency of incentives and charges on platforms in the longer term."

What does this June 2009 consultation paper mean for financial planning AFSLs?
Superficially, the UK FSA's consultation paper seems to mean, in Australian terms:-

- A ban of a financial planning firm profiting by wholesaling a product and putting a mark-up on that product before badging and selling that product. This covers situations such as financial planning AFSLs badging or white-labelling the BTWrap platform, which is a common practice. This conclusion is drawn from the UK FSA document Section 4.15.
- A ban on a financial planning firm receiving volume over-rides. This conclusion is drawn from the UK FSA document Section 4.68 and 4.14.

The same correct rationale that the UK Financial Services Authority is using:

- to ban volume over-rides and
- to ban financial planning AFSLs from profiting by white-labelling and badging other products

should also be applied to Australian financial services regulations for the same reasons – namely to ensure that the consumer will be better off.

2. Disclosure of volume over-rides. Those not disclosing volume over-rides should be prosecuted.

Now, let us remind ourselves what Corporations Law requires to be disclosed in an SoA.

947C (e) information about the remuneration (including commission) or other benefits that any of the following is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice:
(i) the providing entity;
(ii) an employer of the providing entity;
(iii) the authorising licensee, or any of the authorising licensees;
(iv) an employee or director of the authorising licensee, or of any of the authorising licensees;
(v) an associate of any of the above;
(vi) any other person in relation to whom the regulations require the information to be provided; and

Therefore it is very clear that volume over-rides are

- "remuneration (including commission) or other benefits that any of the following is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice" (i.e. the advisor) AND
- "remuneration (including commission) or other benefits that any of the following is to receive that might reasonably be expected to be or have been capable of influencing the authorising licensee"

Therefore, it is very clear that under Corporations Law, volume over-rides MUST be disclosed in Statements of Advice and in other ways. Any AFSL who says they they have no obligation to disclose volume over-rides is simply not being honest with themselves and should be prosecuted. And if commissions are to be banned, then so should volume-over-rides. **Please note:** I am unaware of Count Financial's policy of disclosing volume over-rides.

Some financial planning AFSLs will argue that volume over-rides are a commercial arrangement between the product manufacturer and the financial planning AFSL – and that since these payments are not passed on to the advisors, they need not be disclosed. However:-

- firstly it is patently clear from the discussion above, that the law requires volume over-rides to be disclosed AND
- secondly, there are a whole host of ways that a financial planning AFSL can influence the advice of their representatives. The Count Financial situation illustrates one of those ways, but there are many other ways – some subtle and some not. Apart from everything else, a financial planning AFSL is required to supervise their representatives.

So I think it is very clear, that any arguments that volume over-rides do not need disclosure under current rules, do not stand up to close scrutiny.

3. The FPA's position on volume over-rides is inconsistent and unsustainable.

This then leads us to the inconsistent position that the Financial Planning Association has taken.

- On the one hand, FPA has recently called for a ban on commissions.
- However in the 1/6/09 Asset magazine article "No easy answers on commissions", Leng Yeow reports that *"The FPA's policy is not seeking to ban soft dollar payments, sponsorships or platform rebates."* As we can see from the example above (Count Financial), platform rebates (i.e. Volume over-rides) work just like commissions and can therefore taint advice. Therefore, if commissions are to be banned, the volume bonuses need to be banned – and soft dollar payments, sponsorship, shelf-space fees and all other payments (and financial benefits) from product manufacturers to financial planning AFSLs (and their representatives), both direct or indirect, need to be banned – with the only exception being that which was recommended in the UK Financial Services Authority (**FSA**) publication "Retail Distribution Review", November 2008. That is, *"any payment for advisory services made through the customer's product or investment must be funded directly by a matching deduction from that product or investment made at the same time as that payment."*
- Let us also look at the online Money Management article 13th June 2009 by Lucinda Beaman titled "Licensee volume bonuses not on FPA's agenda". Lucinda reports that *"The payments (volume over-rides) made from financial services and product providers to Australian Financial Services Licensees (AFSLs) will not form part of the Financial Planning Association's (FPA's) current review of remuneration practices in the industry."*

How can the Financial Planning Association possibly sustain this position? It is totally inconsistent to call for a ban of commissions while supporting the continuation of volume over-rides which are simply commission by another name. The FPA also does not appear to be acting consistent with its new code of ethics, in which the first principle is to put the client first.

There is a major question about whether the industry can heal itself – or whether regulatory measures are required. I suspect it is the latter.

Appendix A. Money Management - "Licensee volume bonuses not on FPA's agenda".

http://www.moneymanagement.com.au/articles/Licensee-volume-bonuses-not-on-FPAs-agenda_z485745.htm

Licensee volume bonuses not on FPA's agenda

11 June 2009 | by Lucinda Beaman

The payments made from financial services and product providers to Australian Financial Services Licensees (AFSLs) will not form part of the Financial Planning Association's (FPA's) current review of remuneration practices in the industry.

The payments made by product providers and investment platforms – otherwise known as volume bonuses and shelf space fees – were questioned last week in a public submission to the parliamentary joint committee inquiry into financial products and services in Australia.

These payments appear to be passed on to financial planners in some cases, retained by licensees in others, or prepaid to licensees prior to volume targets having been met. Such payments are understood to be causing headaches for the administrators and receivers of recently collapsed management investment schemes.

In his submission to the inquiry, financial planner Neil Kendall called for platform rebates paid to financial services licensees to be banned. Kendall, managing director of boutique planning firm Tupicoffs, told the inquiry rebates from investment platforms were substantial, influenced investment dollar flows and were not properly disclosed to clients.

FPA chief executive Jo-Anne Bloch confirmed to *Money Management* that the current review of remuneration practices in the financial services industry would focus on arrangements between financial planners and their clients, rather than tackling alternative remuneration (or soft dollar) arrangements, or the issue of volume bonuses being paid at a licensee level.

Bloch said at this point the FPA has chosen to "focus just on the remuneration paid by the client to the planner" and on the "relationship between the client and the planner and getting that right".

The FPA and the Investment and Financial Services Association share a joint code on practices regarding the disclosure of soft dollar and rebate payments. Bloch believes that in recent years the industry has "moved a long way to cleaning up inappropriate practices, having good disclosure and changing behaviour".

"Having said that, we're aware a number of members have said we should be looking at those [issues] more closely," Bloch said.

"We're also aware that [the Australian Securities and Investments Commission] is looking at alternative remuneration, so we expect to be needing to have a look at both issues going forward, but I can't really say when."

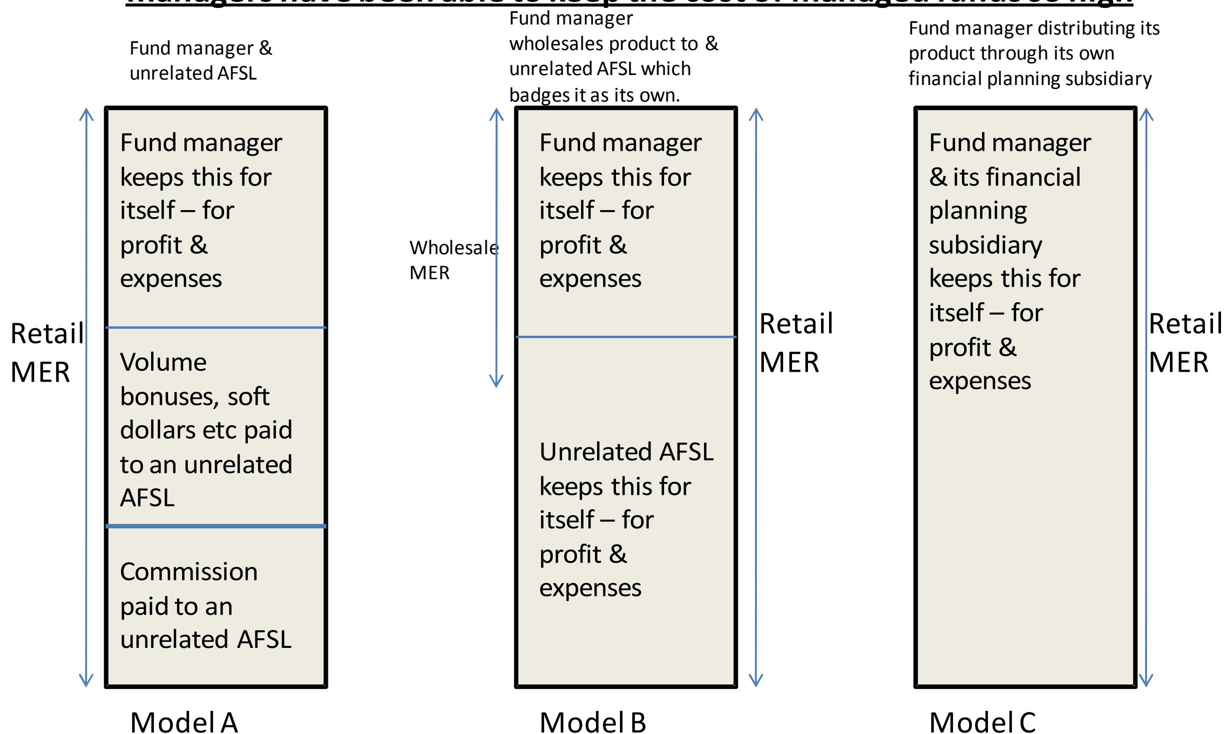
Appendix B. Different ways that Volume Bonuses are paid.

It might be reasonable to assume that volume bonuses are as simple as an extra commission paid to a financial planning AFSL – and yes, it is usually as simple as that. However there are many variations of arrangements which exist, specifically:-

- Sometimes volume bonuses are paid to a third party. Depending on the arrangement:-
  - in some cases, the third party provides a share of the volume over-rides to the financial planning AFSL.
  - in some cases, the third party provides shares to the financial planning AFSL in "yet another entity" in exchange for the volume over-rides.
  - In some cases, the third party provides some services to the financial planning AFSL.

Appendix C. How volume over-rides fit into the overall distribution systems.

This issue is discussed in greater depth in supplementary submission 4. However, this chart below provides a reasonable summary.



Appendix D. the UK Financial Services Authority Bans Commissions.

http://www.ft.com/cms/s/0/96c2c65c-6192-11de-9e03-00144feabdc0.html?nclick_check=1

FSA to ban commission for advisers

By Matthew Vincent

Published: June 25 2009 15:23 | Last updated: June 25 2009 21:25

Thousands of independent financial advisers, and up to half the IFA industry, are predicted to leave the business as a result of a planned ban by the City watchdog on commissions they receive for selling investments.

In a radical overhaul of the rules governing IFAs, the Financial Services Authority said on Thursday that payments from fund managers and life assurers to advisers would be outlawed in three years.

The FSA said it intended to drive "commission bias" out of the system and ensure "recommendations made by advisers are not influenced by product providers".

Commission payments have been blamed for mis-selling scandals over the past 20 years involving mortgage endowment policies, personal pensions and stock market-linked bonds.

The watchdog said it would ban product providers from offering commission to secure sales and ban advisers from recommending products that automatically paid commissions.

Instead, investors will be told up front how much advice would cost and will be able to choose whether to pay a fee or have the cost deducted from their investment. Crucially, the amount the adviser receives for recommending a product will be negotiated with the investor and not determined by the provider.

"This is a great day for the consumer," said Andrew Fisher, chief executive of advice firm Towry Law. "It is a ban on the bribery and corruption that has plagued the industry. Mis-selling driven by commission should now end."

The Association of Independent Financial Advisers said IFA firms would have to foot an initial £210m bill for the changes, which would work out at about £6,000 per adviser.

Oxera, the consultancy group, estimated about 20 per cent of firms would exit the business as a result. Aviva, the life insurance group, forecast that the figure would be closer to 50 per cent.

About 80 per cent of the work done by Britain's 35,000 IFAs is on a commission basis, according to estimates from unbiased.co.uk, the professional advice website. A further 50,000 financial advisers, who work as "tied" or "multi-tied" agents of banks and insurance companies, also operate on commission.

"Changes in the commission model will have a significant impact on the number of advisers," said Drew Fellowes, head of insurance advisory at KPMG.

"The FSA position on factoring [advancing payments to advisers] will exacerbate this. Consumers will lose out if advisers exit the industry and providers cannot meet demand for low cost distribution."

Investment providers voiced concern that the needs of lower income investors would not be met.

Appendix E. Key excerpts from UK FSA's "Distribution of retail investments: Delivering the Retail Distribution Review" June 2009.

http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf

- **Executive Summary**
  Our proposals involve:
  • improving the clarity with which firms describe their services to consumers;
  • addressing the potential for adviser remuneration to distort consumer outcomes; and
  • increasing the professional standards of advisers.

- **Improving clarity for consumers about advice services**
  We are proposing changes to make it easier for consumers to distinguish between the different forms of advice on offer to them, with all investment firms clearly describing their services as either 'independent advice'or 'restricted advice'. Our rules and guidance will ensure that firms that describe their advice as independent genuinely do make their recommendations based on comprehensive and fair analysis, and provide unbiased, unrestricted advice. Equally, where consumers choose to use a restricted service – such as a firm that can only give advice on its own range of products – this will be made clear.

- **Addressing the potential for remuneration bias ('Adviser Charging')**
  Under our proposals, all firms that give investment advice must set their own charges, in agreement with their clients, and will have to meet new standards regarding how they determine and operate these charges. The proposals bring to an end the current, commission-based system of adviser remuneration: we propose to ban product providers from offering amounts of commission to secure sales from adviser firms and, in turn, to ban adviser firms from recommending products that automatically pay commission. Consumers will still be able to have their adviser charges deducted from their investments if they wish, but these charges will no longer be determined by the product providers they are recommended.

- **Increasing professional standards of advisers**
  We plan to raise the minimum level of qualification for investment advisers, and to institute an overarching Code of Ethics and enhanced standards for continuing professional development.We are also proposing visible maintenance and enforcement of these standards through the establishment of a Professional Standards Board (and will consult separately on this in the fourth quarter of 2009).

- **Adviser Charging: what it means for product providers**
  4.14 To end the system of product providers offering amounts of commission to adviser firms, we are proposing new responsibilities on product providers, as well as on adviser firms. Just as the rules we are consulting on would prevent adviser firms from receiving commissions set by product providers, we are also consulting on a ban on product providers offering commissions (or other payments or benefits) in relation to advice on investments given to retail clients.

  4.15 This requirement is not designed to prevent product providers from offering different product prices through different distribution channels (for example, a large

IFA network might be able to secure a product with a lower product charge than a sole trader). In order for the market to operate competitively, we are content that different product prices will continue to be available through different channels, but where firms access lower prices they will have to pass these on completely to their consumers, without retaining a margin.

- **Distinguishing product and adviser charges: a ban on negative charges**
  4.18 This means that we are consulting on rules that would ban, for example, products that offer initial allocation rates greater than 100%. At present, such products are usually accompanied by higher annual management charges, which are less transparent to the consumer and, in future, could lead to the misperception that adviser charges payable have been offset and adviser firms' services are therefore free. Under the new rules, offering products with negative charges in this way would breach the requirement for product charges and adviser charges to be kept distinct.

- **Regulating platforms and their charges**
  4.68 In drafting the rules contained in Appendix A, we have taken every effort to ensure that adviser firms will not be able to continue to receive commissions, profit shares or other remuneration determined by product providers and other third parties. At the same time, we have begun to receive questions from the industry about the acceptability of other firms, such as fund supermarkets, continuing to receive commission set by product providers. These, in turn, lead to wider questions about the best way to achieve transparency of incentives and charges on platforms in the longer term.

- **Unwinding of cross-subsidies**
  20. Oxera reviewed whether the proposals would cause any change in intermediaries' pricing strategy.

  21. A cost study by Deloitte found that commission-based remuneration often means that investors of large sums subsidise investors of small sums. This study also found that, post–RDR, intermediaries would typically design their fee structures to replicate existing commission cash flows. Overall, in the short term, the price of advice seems likely to be about the same as it is now.

  22. Oxera reviewed whether, in the longer term, to the extent that intermediaries charge hourly fees, this would remove the cross-subsidy between investors of large sums and investors of small sums. Oxera also reviewed whether, where intermediaries use volume-based fees, greater clarity about the costs of advice would mean investors of large sums more frequently negotiate a discount. This would also lead to an unwinding of the cross-subsidy. Oxera concluded that unwinding of cross-subsidies is a realistic possibility in the longer term.

  23. If cross-subsidies are unwound, investors of smaller sums would face higher costs of advice. This may cause them to switch from the independent to the non- independent sector for advice, or not to seek advice, instead, for instance, putting their money into a savings account. Typically a consumer driven by regulation to select the next best alternative would suffer a loss of consumer surplus. In the present case, however, consumers' investment returns may be increased by switching to lower cost investment vehicles.

24. On the other hand, investors of larger sums would benefit from the unwinding of cross–subsidies since they would pay less for advice. With the price of advice more reflective of the cost, there would be a gain in economic efficiency since investors of large sums, who typically value independent advice more than investors of small sums, would be more likely to use this service.

- **Improved trust leading to an increase in the number of (appropriate) sales**
  35. The proposals are expected to improve consumer confidence by removing some negative perceptions of the advisory process, which undermine confidence and often deter people from seeking advice. Consumer research by BMRB Social Research finds trust to be a more important factor than price for selecting an adviser, and that commission damages trust in advisers, when consumers take these payments into consideration. Where a lack of trust exists it means that consumers are unlikely to be willing to accept advisers' recommendations (or even seek financial advice). The behavioural economics literature finds that consumers are strongly averse to the potential of losing what they own; are reluctant to rely on someone else to secure a benefit; and factor in the cost of regretting a decision into their decision-making process. Such is the extent of these behavioural biases, they would be willing to forgo a beneficial opportunity such as an appropriate new investment. Such opportunities are more likely to be foregone in the absence of trust.

  36. Consumer research by Strictly Financial suggests that confidence can be established in advisers through the demonstration of knowledge and qualifications. The research by BMRB Social Research also found that wider scope of advice improves trust. So in the long term, the professionalism and independence proposals, together with the removal of commission payments, should help to improve levels of trust. This means that consumers are more willing to accept recommendations made to them, and that some beneficial transactions take place that would not have taken place under the current regime. In the longer term, this may serve to narrow the savings gap.

Appendix F. CPA Web site - “Fingers in the Pie”.

(http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-541CAE0F/cpa/hs.xsl/724_24883_ENA_HTML.htm)

Fingers in the pie

Wrap fees are disclosed in so many different documents it would take a forensic accountant to work out who gets what.

By Prue Moodie

The first thing most veteran observers of the financial services landscape agree on is that the consolidated reporting and portfolio services known as 'wraps' have generally not resulted in lower client fees.

People whose financial advisers put them into an investor-directed portfolio service (or IDPS, the technical name for wraps) are probably still facing at least a 1.5 per cent portfolio fee before paying any advisory fees.

Even investment fees, the fees that fund managers charge, don't seem to have dropped by much.

What is most astounding to a financial services outsider is the sheer number of pieces the IDPS process can take out of a client's investment pie.

There are investment fees, administration fees, volume bonuses, adviser fees, trustee fees, contributions fees and switching fees. While, strictly speaking, the notorious shelf-space fees don't come out of a client's portfolio, they may affect final pricing.

The complexity is a turn-off for consumers who are used to easily assessing the value of services they purchase. Accountants moving into financial planning face a challenge if they want to stick to a simple fee-for-service charging model, and also use a platform.

Unless financial planners have their own licence, they will often have little choice but to participate in a tangled web of percentage fees, sharing arrangements, and rebates, while trying to reassure clients that they will maintain pricing integrity.

The basic system works as follows:

First the fund manager charges the investor about 100 basis points (1 per cent) to invest in a particular product. In addition to that, the wrap service charges the investor about 60 basis points per investment option as an administration fee. In addition to these two charges, financial advisers can opt to have their advisory fees added in.

If the adviser has their own licence, they can opt for no adviser's fee. But if licensed through a dealer group, the adviser will usually have to abide by the dealer group's rules.

Let's say the dealer group opts for a 40-basis point adviser's fee. The dealer group (which provides the adviser with a financial planning licence, training and probably various kinds of computer support) might keep 20 basis points, and pass 20 basis points on to the adviser.

Under this hypothetical scenario, which doesn't include some of the smaller fees, the client would be charged 2 per cent: the investment fee, the administration fee, and the adviser's fee. The adviser can choose to rebate either the full 40-basis-point adviser's fee, or just their 20-basis point share, and then charge whatever is appropriate. But the adviser probably can't stop the dealer group taking a cut.

Clients would see all the fees, as well as the rebate, itemised in their investment statement. How often they get an investment statement will depend on the arrangement their adviser has with the wrap. This basic model seems understand-able, if a little convoluted. But in real life it's harder to figure the situation out because of all the deals going on behind the scenes.

The first behind-the-scenes payment is the shelf space fee. It's paid by fund managers to each wrap (most wraps, although maybe not all, charge shelf fees) where the fund manager wants to have its products listed.

Shelf fees are kept by the wrap

Ian Knox is the CEO of a compliance and training company called Paragem Partners, which also aims to be an alternative service provider for financial advisers who don't want to be part of a dealer group.

He puts the average shelf-space fee at about $10,000 per product per year. But a single fund manager may have multiple products with a wrap – for example, an Australian share fund, a protected income fund, or a fixed-interest fund – and it has to pay a shelf fee for each one.

Giulio Russo is head of wrap services at Macquarie Advisory Services, a unit of Macquarie Bank and attached to one of the biggest wrap providers in Australia. Russo says Macquarie's shelf-space fees are charged on a cost-recovery basis. At Macquarie they are $5500 per manager, plus $3300 to $4400 per investment [product] per year, he says.

Marianne Perkovic is chief executive of dealer group Count Financial, which has attracted attention for its ability to negotiate fee discounts. In the industry there has been some discussion about what percentage of these discounts should flow to advisers.

Perkovic talked to INTHEBLACK about Count Financial's approach to fees from its badged or white-label version of the BT wrap. 'The shelf fee is not really our issue,' she says.

'We've never had a problem with not having on the wrap an investment that has been recommended by our asset consultant. And the shelf fee is not an issue for the client because it doesn't filter down.'

The next candidate for behind-the-scenes negotiations is investment fees, or management expense ratios.

Perkovic says that because of the dealer group's weight of funds ($5bn plus), Count clients may get a discount of 10 basis points off the 'rack rate' MER of investment products. That discount will be deposited directly by the wrap service into the client's account and disclosed on their statement.

The actual discount off the MER is likely to be at least double that, however, and Count receives at least as much as the client, and maybe more.

How much Count may get, says Perkovic, is disclosed in the financial services guide. She says the adviser doesn't get a share of the MER discount 'because that would represent a conflict.'

Macquarie's Russo says Macquarie also discounts investment fees for clients but doesn't pass any share in the discount on to dealer groups. He didn't comment specifically on the wraps that Macquarie badges for dealer groups.

Rob Ferguson, a CPA with his own financial planning practice called Ferguson Betts, says he'd like clearer accounting of how shelf fees and MERs interact. 'The wraps say the rebate they are giving our clients is based on their clout with the institutions,' he says. 'But how is that rebate being costed? Is it also based on shelf fees? They don't tell you.'

Ferguson says he finds it frustrating that he can't negotiate lower investment rates when he goes directly to a fund manager, despite having considerable client funds.

The third item on the behind-the-scenes negotiating agenda is volume bonuses. These are discounts off the standard administration fee. 'For example,' says Perkovic, 'Count clients pay an administration fee of 80 basis points.' (Perkovic is bundling the advisory fee in with the administration fee in this example.)

'Count gets about 40 basis points,' she says. 'That's the beginning point. Count may get more depending on how much it puts through. If we get a rebate we keep some of the rebate and give the adviser the rest.'

In other words, when Count pushes the core administration fee below 40 basis points it collects the saving and decides how much to give each adviser, based on the size of the adviser's practice. The adviser then decides how much to give the client.

Perkovic says the statement of advice the client receives at the beginning of the relationship will give the breakdown of how much of the volume bonus per product may go to Count.

Then the client can look at their portfolio statement to find out how much their adviser is rebating to them.

Paul Brady, a certified financial planner and principal at planning firm Brady & Associates, approves of wraps because of their functionality. 'Wraps get bagged as being expensive and serving the purposes of advisers,' says Brady.

'But if you can make use of scale, then you can bring total costs down for clients while also offering a better service.

'On the pricing side, there's a bit of competition but I think we could have more,' he agrees, also noting that shelf fees should be transparent.

Brady belongs to a group of similar firms, which, negotiating as one bloc, has lowered the effective costs of standard administration fees charged by the group's wrap service provider, Macquarie. 'We just pass the reduction on to the client. But that could have been a volume rebate that we didn't pass on,' he says. 'We would have had to disclose that to the client.

'This suits me because I'm a principal,' Brady continues. 'Some dealer groups retain all or part of any negotiated reductions. The profitability of a number of advisory firms depends on the volume rebates.'

Ian Knox thinks that the starting-point administration fee should be 30 to 40 basis points, but he says advisers who negotiate together in order to achieve economies of scale could force the price significantly lower than this.

ASIC recently asked for submissions about its review of the regulation of IDPS schemes. The review included a proposal that product disclosure statements for certain linked financial products should include a standardised fees-and-costs template, an additional explanation of fees and costs, an example of annual fees and costs for a balanced or similar fund, and a boxed consumer warning.

The disclosure of shelf fees is not specifically dealt with in ASIC's current IDPS policy and is not included in its review of IDPS policy.

ASIC is still in consultation phase, and hopes to announce its revised policy by March or April 2008.

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No easy answers on commissions

Monday, 01 June 2009 | Asset | Leng Yeow

While it is the product manufacturers who set the remuneration terms for financial planners by building commissions and trails into products, it is the financial planners who are hammered for accepting them.

For example, Colonial First State's flagship FirstChoice platform has a bundled fee structure, which includes an inbuilt trail of 60 basis points that can't be stripped out.

Similarly, Australia's largest retail managed fund, the $15 billion Macquarie Cash Management Trust (CMT), has a fixed 27.5 basis point trail built into its 1.1 per cent management expense ratio. Fee-for-service financial planners must take the commission and manually rebate it back to the client.

AMP's Flexible Lifetime Super and Allocated Pension product also includes a 44 basis point trail built into its MER, and most insurance products build a trail into premium rates.

In May, the Financial Planning Association courageously recommended that its members transition to a fee-based model by July 1, 2012, and no longer allow product providers to dictate their remuneration.

The Investment and Financial Services Association should be equally as gutsy and recommend to its members that they phase out inbuilt commissions from their products.

Product design is one of the areas Senator Nick Sherry, the federal Minister for Superannuation and Corporate Law, has vowed to look at as part of his Ministerial Communiqué of Principles for Superannuation.

In April, Senator Sherry confirmed his review would also examine conflict of interest, financial systems, default funds and legacy products. He said he was eager to effect change in remuneration arrangements.

The parliamentary joint committee on corporations and financial services, which is running the inquiry into financial products and services (and receiving submission up until July 31), is also examining the sales culture of financial planners and the marketing techniques of product manufacturers.

Federal MP Bernie Ripoll, chair of the committee, said in a speech to the Institute of Actuaries in April that the inquiry would look at the role institutions play in perpetuating the use of trails and commissions.

"It's not just financial planners, but the institutions," he said. "Financial planning is an essential service, so in that regard we need to get it right and rebuild confidence in the sector." He said the inquiry would focus on the role of financial planners, the role of commissions, the way products are distributed and marketed, and licensing arrangements.

The committee is scheduled to report by November 23.

Product manufacturers are preparing for the worst. Financial services giant AMP is the latest institution to do a semi-backflip on fees and commissions. On May 25, it launched its Flexible Lifetime Super Easy product, its first retail superannuation product that does not pay commissions to financial planners.

Instead, it charges administration fees of $1.50 per week, and management fees of 0.50 per cent for the cash option or 0.65 per cent for the balanced fund. Financial planners can charge a one-off establishment fee of $400 plus GST or dial up an advice fee capped at 0.22 per cent a year.

AMP director of product manufacturing Paul Sainsbury says that Flexible Lifetime Super Easy meets the federal government's request for more simplification in super.

Macquarie is expected to introduce changes to its CMT in the second half of 2009 that will allow planners automatically and electronically to opt out of receiving commissions.

And trails on FirstChoice may become a thing of the past.

This month Colonial is also launching its new full-service wrap, FirstWrap, which does not pay trails but allows planners to charge up to 2.2 per cent in advice fees.

Colonial launched FirstChoice Wholesale in 2004 to complement the existing FirstChoice platform and enable planners with different remuneration and fee structures the choice of taking a commission or charging a fee for service.

By running two options side by side, Colonial, like most manufacturers, hedged its bets. It caters to the needs of fee-based planners but is careful not to upset the establishment. It does not believe that eliminating inbuilt commissions on FirstChoice contradicts its long-standing position that financial planners, and their clients, should be able to choose their method of payment.

That's the company line that Colonial's former head of distribution, Richard Nunn, used to toe. He later became Commonwealth Private Bank general manager, before joining MLC last month.

Now the executive general manager advice and marketing, for MLC and NAB Wealth, Nunn says commissions should be banned. MLC chief executive Steve Tucker stands by his appointment of Nunn, saying the pair are philosophically aligned.

In April, BT Financial Group distanced itself from commissions, calling on planners in its Securitor dealer group to abandon the commission-based remuneration model and adopt a fee-based one instead.

"The future is about unbundling advice from the product," BT's general manager of advice and private banking, Geoff Lloyd, says.

But BT still uses volume bonuses to encourage its advisers to sell more, and it is understood Lloyd recently offered Securitor's top writers a bigger slice of the rebate pie.

David Haynes, general manager of Industry Fund Services, supports the FPA's recommendation to move away from commission payments, but is cynical. "There are many in the retail sector getting commissions but not calling them commissions," he says. "There are remuneration models being touted as fee for service but there's a commission peeping through. As long as people are able to benefit from pushing product, you have a commission structure."

Under Securitor's new principals, clients should be able to turn off their ongoing fees if they feel they're not getting adequate ongoing advice.

"The basic principles are: can the client see the fees, do they agree to the fees and can they turn off the fees at any time," Lloyd says.

David Whiteley, executive manager of Industry Super Network argues that automatic ongoing fees need to be prohibited, and clients should be required to opt in to paying fees each year rather than requiring them to opt out of ongoing fees.

Bruce Baker, principal of Puzzle Financial Services and member of the Boutique Financial Planning Principals Group, agrees. "The FPA's proposal is a step in the right direction but it misses the main game," he says.

"Even after commissions are gone, and that needs to include volume overrides, we will be in precisely the same position - that is, there will be some AFSL representatives who are salespeople and others who are true advisers. The consumer still needs to distinguish one from the other."

BT chief executive Rob Coombe is not pre-empting what the government will do, but he says the industry will benefit from legislation that keeps the cost of financial advice down.

BT does not believe Sherry will mandate that fees on super guarantee contributions fall under 1 per cent.

Since its inception in 1997, the BT Wrap has had no inbuilt commissions, but allows advisers to dial up an advice fee, Coombe says. "The platform is the administrator of this charge and discloses it as a separate, dollar-based line item in the customer's monthly statement."

MLC stopped paying commissions on its platforms in 2003, and in 2006 launched a fee-for-service version of its MasterKey platform.

Sherry has said he won't ban commissions, but there's speculation he will force product manufacturers to separate product fees from advice fees.

If that happens then planners and their clients will have greater control of how, and how much, they charge and pay for advice. That pushes financial planning closer to becoming a fully fledged profession.

The changes will be too much, too fast and far too hard for many advisers after decades of accepting commissions. Furthermore, they'll struggle to justify their fees to clients in the middle of a recession.

It's not surprising then that the Association of Financial Advisers, a group that primarily represents life advisers, strongly opposes the FPA's recommendations.

It's not just progress that the AFA opposes; it also resents being told what to do. AFA national president Jim Taggart says members do not want their professional body to tell them how to run their business. In other words, it is not the role of a professional association to offer leadership; it is merely a mouthpiece for its membership.

The FPA has had some mixed responses from its membership to its remuneration policy. Some, such as certified financial planners Peter Gilkison and Neil Kendall, fully support FPA chief Jo-Anne Bloch, while others are vehemently opposed.

Others, like Baker, say Bloch hasn't gone far enough, and that the industry has got off lightly.

The FPA's policy is not seeking to ban soft dollar payments, sponsorships or platform rebates. It quarantines legacy products and excludes insurance.

On that note, the AFA should stop grumbling.