

Business *Spectator*

Commissioning clarity

Alan Kohler

Published 9:14 AM, 26 Apr 2010 Last update 10:00 AM, 27 Apr 2010

The government has finally acknowledged that the wealth system should be like the health system – that is, ‘doctors’ shouldn’t be allowed to sell prescriptions on commission from the drug (fund) companies.

Financial Services Minister Chris Bowen has said that from 2012 all commissions will be banned, that consumers will have to opt into receiving advice, and that there will be a statutory fiduciary duty on advisers to put clients first.

The phrase “advice-based distribution” for financial products will be a thing of the past – sales will be sales, and advice will be genuine advice.

Legislation is so obviously needed that it’s amazing and deplorable that it has taken so long. This commentator has been campaigning for legislation against financial planning commissions, and using planners as a subversive ‘advice-based’ sales network, for the best part of a decade.

Last year the Financial Planning Association came on board with a decision to phase out commissions from July 1 2012, which was fiercely opposed from within the organisation.

A rear-guard action led to a set of soft recommendations from the Ripoll Inquiry, set up last year in response to the Storm Financial collapse. Ripoll merely recommended that the government “consult with” the industry to find the best way to “cease payments from financial product manufacturers to financial advisers”.

Shadow Treasurer Joe Hockey appears to be still pushing the single argument used by those supporting commissions. He is quoted this morning as saying: “commissions allowed low-income earners to access financial advice because they paid through commissions, not upfront fees.”

This argument has been comprehensively refuted. Most low-income earners don’t need expensive advice, just a decent super fund, and allowing conflicts of interest is not a proper to subsidise them anyway.

The Australian Securities and Investments and Commission, and its former deputy chairman, Jeremy Cooper, now heading up an inquiry into the superannuation system, have been taking a much tougher line than Ripoll.

And an active and growing movement of financial planners refusing commissions and charging a “fee for service” – usually a percentage of funds under advice – has developed.

One by one the banks and wealth managers have sniffed the wind and, trying to avoid legislation, said they were moving away from commissions. And with former NSW Opposition Leader, John Brogden in charge, the Investment and Financial Services Association, representing all financial product promoters, finally signed up to the program last year.

But it has been obvious for years that industry self-regulation was not the answer and that legislation was required: the associations don’t represent the entire industry, and their solutions were inevitably patchy and self-interested. Moreover the industry was rapidly trying to entrench to percentage-based fees that are almost as bad as commissions – a sort of back-door commission.

Only the government could make rules that applied to everyone, but it has been prevaricating for years – hostage to a powerful financial planning lobby trying to protect a system that has created enormous wealth.

The key to that wealth, apart from the juicy cash flows, is that while accounting practices that charge by the hour sell for about one year's worth of income on the retirement of the accountant, financial planners get about four times annual revenue when they sell their commission streams. A sudden ban on commissions would wipe out billions of dollars of goodwill embedded in financial planning practices.

The government has been advised that it would cost billions in compensation to financial planners for the loss of goodwill assets if existing commissions were simply banned.

Accordingly it looks like Bowen's going with the FPA's approach of banning all new commission arrangements from July 1 2012 – exactly one year after the FPA issued its ground breaking consultation paper. The plan is designed to protect goodwill based on existing commissions, as well requiring the clear separation of advice and sales.

In a sense the government is bringing up the rear, putting into legislation what the industry lobby has already accepted.

Bowen has also accepted the only tough Ripoll Inquiry recommendation: to put a fiduciary duty into legislation. This means a financial adviser cannot sell products – he or she must only advise in the best interests of the client.

Most say they already do this, of course, in which case the legislation won't be a burden. But in fact the banks and wealth managers explicitly use planners as their distribution network, and they can't have it both ways.

The next question is: how will the banks and wealth managers sell and distribute their products after 2012 if financial planners can't do it? This will only be clear from the detailed legislation, but it's likely that financial planners will have to choose between being advisers and sales people.

Which means Australia will finally have a system of financial advisers who give advice to those who ask for it, have a clear fiduciary duty to their clients, and who get paid by those clients, and brokers who flog products.

It should have happened a decade ago. A lot of people would not have been ruined by collapses such as Westpoint and Storm if it had.