Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Commonwealth Bank of Australia and its associated Australian entities (CBA)

Round 2 Hearing - Financial Advice Closing Submissions

PART B - QUESTIONS ARISING FROM THE CASE STUDIES

Case study: Fees for no service

1. As it noted in its Part A submissions, CBA acknowledges that the circumstances covered in this case study are unacceptable and have impacted a large number of customers. The issues should not have occurred and when they did, they should have been identified and dealt with in a more timely manner. Charging customers fees for services that are not provided is not acceptable and for that we apologise. On 13 April 2018, CBA noted in its media release concerning the Enforceable Undertaking entered into by Commonwealth Financial Planning Limited and BW Financial Advice Limited that it was engaging with regulators, industry experts, consumer advocates and its people to achieve better outcomes in financial advice. In circumstances where CBA is still in the process of its consultation, it has elected not to provide a response to the industry and policy questions outlined by Counsel Assisting concerning this case study. CBA will provide an update on its consultation later this year.

Case Study: Platform fees

Question 1: Does vertical integration of platform operators with advice licensees serve the interests of clients? If so, how?

2. Vertical integration can create a beneficial connection between the customer and product design and risk management. However, actual or perceived conflicts of interest can exist. We acknowledge the concern that the ownership of financial advice services by banks has the potential for conflicts of interest. Appropriate measures must be in place to manage such conflicts. Conflicts of interests can be managed appropriately with the right product design, internal structure and remuneration policies and a strong operational risk and compliance culture.

3. In financial services, vertical integration (such as the integration of platform operators and advice licensees in the same business) is recognised as having significant benefits to customers. As ASIC notes, *"It can provide economies of scale and other benefits for both the financial institution and its customers. The economies of scale may allow customers to access advice at lower cost. Customers may choose to obtain both advice and financial*

products from a vertically integrated institution because of the convenience of a relationship with a single financial institution. They may also value the perceived safety of dealing with a large institution, and have trust and confidence in the ability of the institution to both deliver the services and compensate them appropriately if required."[1]

4. The benefits that flow to customers arise from economies of scale and economies of scope (i.e. breadth of products and services that can be offered to customers). Large vertically integrated businesses also have greater capacity to undertake capital investment in technology and innovation, as they strive to develop better products and services for customers, as well as risk and monitoring systems. Vertical integration can also deliver practical efficiencies to the extent that the product administration can be integrated. This is particularly true for advice businesses. Without strong platform partnerships, advice licensees would need to deal with a vast number of product providers on a bilateral basis, each with different administration and reporting systems and requirements. This would be inefficient and would add cost to the advice process.

5. In the context of the Australian financial services industry, if large vertically integrated businesses were replaced with a greater number of smaller entities and individuals, this would significantly erode the benefits that customers currently enjoy.

6. While vertical integration offers benefits to customers, it also inevitably gives rise to certain conflicts of interest which need to be managed. All vertically integrated businesses in the Australian financial services industry are required to and should place a strong focus on identifying, assessing and managing potential and actual conflicts. This includes platform or financial product businesses and financial advice licensees operating within the one conglomerate structure. A focus on managing conflicts of interest allows vertically integrated businesses to deal with related parties in a way that promotes customers' best interests, because it ensures that the entity does not prefer its interests over that of its customers.

7. The effective management of the conflicts which arise in a vertically integrated business should include:

   (a) having clear separation in the way the various components of the business is operated, with different business functions provided by different corporate entities;

[1] ASIC REP 562 Financial Advice: Vertically integrated institutions and conflicts of interest, released 24 January 2018 p5.

(b) entities should generally have majority independent boards (and independent chairs) as is required by *FSC Standard 20 Superannuation Governance Policy* for superannuation entities and distinctly separate management teams;

(c) vertically integrated businesses should engage both affiliated and unaffiliated advice licensees and manage information sharing with those parties in the same way, with the same contracts and obligations in place. This indicates a common distribution approach for each licensee, whether a related party belonging to the same overall group of companies or not.

8. It should also be recognised that the law provides additional customer safeguards with obligations under *the Superannuation Industry Supervision Act 1993* (Cth) and the *Corporations Act 2001* (Cth), which require trustees to act in the best interests of members, and advisers in the best interests of their customers, and either case where there is conflict to prioritise the interests of their members or customers.

9. We note these obligations are likely to be enhanced soon. As part of the Government's response to the Financial System Inquiry (2015), the Government accepted the FSI's recommendations to introduce design and distribution obligations for financial products to ensure that products are targeted at the right people (FSI recommendation 21). If implemented, these changes will increase the obligations on all product/platform providers and distributors (irrespective of the extent to which they are vertically integrated) to ensure the products they issue and manage meet the desired target market.

Question 2: Why should a platform operator continue to receive a fee or rebate from a fund manager calculated by reference to the value of client funds invested in the fund if that fee or rebate is not wholly passed onto the client whose funds are the basis for the fee or rebate?

10. Following the implementation of the FOFA reforms, any payment from a fund manager for a new arrangement is for services provided by the fund manager and contributes to the cost incurred by the platform operator of administering the products on the platform. These are all calculated on a flat dollar basis. Payments from fund managers to platform operators in relation to pre 1 July 2013 arrangements are grandfathered and may be calculated by reference to volume.

11. Fees received from fund managers in the manner described above help ensure administration fees remain competitive for customers. The removal of these fees (including the volume based fees) could result in higher platform administration fees to cover the costs of administering funds on the platform.

Question 3: If platform operators continue to automatically deduct advice fees from clients' investments, why should the platform operators not be required to have controls in place to ensure that subdivision (b) of division (3) of part 7.7A of the Corporations Act has been complied with? Put another way, why should platform operators not be expected to ascertain that there is a lawful entitlement on the part of fee recipients to the moneys that the operators automatically pay to the fee recipients at the expense of clients?

12. In its Part A submissions (paragraphs [90] and [91]) CFSIL agreed that there have been instances where it has not consistently met community expectations in relation to the deduction of fees from customers' accounts. CFSIL outlined the steps it has taken to improve its activities and systems. Its concessions in that regard relate to the obligations that CFSIL has to its customers.

13. The question posed by Counsel Assisting asks whether there should be additional obligations imposed on the platform operator to ensure compliance with legal obligations that an adviser or advice licensee has to its customers which are already contained in the contractual arrangements that exist between those parties.

14. We consider that it is not reasonable or practical for platform operators or product issuers to duplicate the obligation that the adviser or advice licensees have to monitor these obligations.

15. When a customer enters into an arrangement and agrees for their adviser to charge an adviser service fee via a product, there are effectively three contractual arrangements in play. These are the arrangements between:

    (a) the adviser and the customer (the ongoing service agreement) and the associated obligations relating to Fee Disclosure Statements and the Biennial Renewal (Opt-in);

    (b) the platform operator/product provider and the adviser/licensee (to allow the adviser access to and ability to charge via the product); and

    (c) the customer and the product provider (to allow the product to pay the fee to the adviser).

16. Each of these contracts is separate.

17. The platform can be used as a mechanism to facilitate the remittance of adviser service fees under an annual ongoing fee arrangement. This fee can be deducted where the member has authorised the trustee (in superannuation) to pay the stipulated amount from the member’s account (the amount can be specified in the application form or separate authorising document), and subject to the terms of the relevant trust deed.

18. On the other hand, the contract for services and delivery of those services is one that exists between the customer and the adviser. The product manufacturer has no visibility of the services agreed to under the ongoing service arrangement and whether those services have in fact been delivered. It would be duplicative and onerous to seek to require any other party apart from the advice licensee to positively attest to an adviser's compliance with the appropriate obligations. The principal obligation should always remain on the financial adviser to ensure there is a lawful entitlement on the part of the fee recipient to the monies the operators pay to them. This should remain the main way to protect client interests given the adviser has the principal contractual arrangement and dealings with the client.

19. There would also be practical difficulties in imposing a monitoring obligation on the platform provider. A customer may authorise the fee for their ongoing service arrangement to be funded via adviser service fees from multiple products. As such, the product provider may not have visibility over the entire fee charged for the ongoing service arrangement, or the services to be provided. That is, there is often not a direct correlation between the fee paid by the product provider, and the service provided by the adviser, which means it is unclear what the product provider would be seeking to positively attest. In order to produce annual Fee Disclosure Statements and conduct the Opt-in process, financial advisers and licensees will often be required to consolidate and communicate fee information from various product providers where the fee is charged across multiple products.

7 May 2018