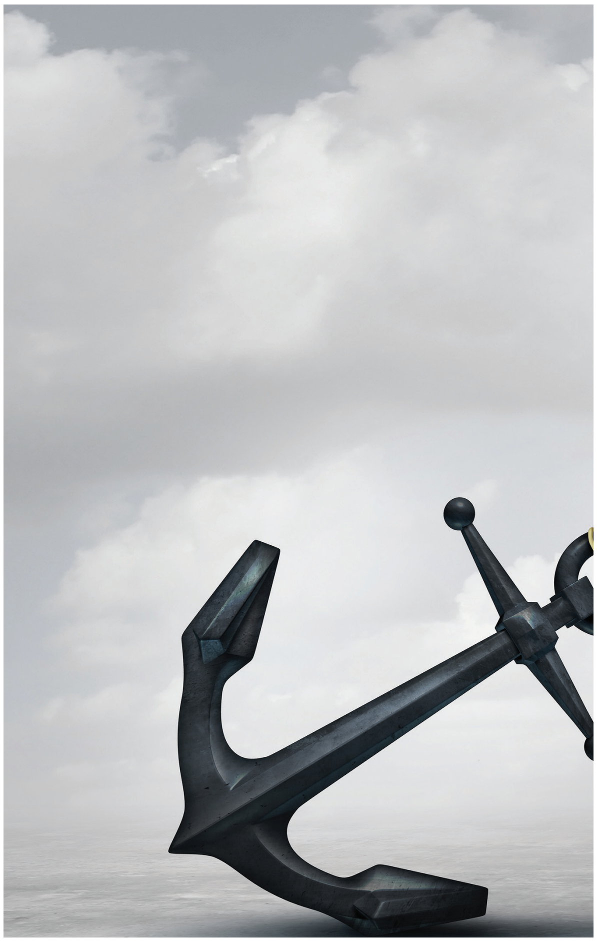
NEWS ANALYSIS

Trial by trail

A shock Productivity Commission recommendation that trail commissions be banned could decimate the industry if implemented, argue leading brokers



THE AUSTRALIAN Lending & Investment Centre may be one of the leading broking businesses in Australia, but managing director Jason Back says the removal of trail commissions could have "serious ramifications".

"We would need to have a serious look at our cost structures and review options like having a smaller support staff, or review our location and premises; our cost-to-income ratio is a measure that we always keep an eye on," he says.

Having built a successful single-broker business over 15 years, Daniel O'Brien, of PFS Financial Services, says that, while banning trail wouldn't kill his company, it could affect his ability to provide quality ongoing client service.

"Because I have an existing trail book and we do on average about $15m a month, I could survive on upfront commissions," he says. "But what will happen without trail is we will earn less, which means we can't have as much infrastructure and resources that are about delivering ongoing service and value to clients."

Expecting an exodus

ProSolution Private Clients director Stuart Wemyss argues that the removal of trail commission on future loans – assuming the measure would be grandfathered – would create unsustainable business models for 95% of existing brokers.

"If all you have to rely on is upfront commission, forget about it," Wemyss says. "Brokers, at best, probably make a small profit on the upfront commission. In many cases, they just break even, and then on some deals make a loss. The upfront pays for all the time and effort you take in acquiring that customer and getting the loan settled, and the trail is typically the profit – that's how most businesses operate."

In the post-GFC environment, with the combination of commission cuts and banks pushing more of the transactional administration onto brokers – like valuations – brokers now do much more for less. Recent regulatory intervention has also made brokers' jobs more time-consuming, and Back says there are now more loans "out of the box than in".

Funding growth, business acquisition and marketing could be out of the question on upfronts, and based on research showing that 40% of financial planners might leave the industry once a degree is required to practice, a similar mass exodus may face the broker market.

"I'd imagine if trail commissions were removed you would probably be looking at a similar sort of result, and it could be even more than 50%," Wemyss says.

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O'Brien expects a disproportionate impact on new brokers.

"Well-established businesses like us can tinker with the model, but what about the new and up-and-coming guys?" he says. "It's not going to be as attractive or appealing to come and stay in the industry. The thing about making good money in a profession is you get the best people; if brokers are paid a lot less, we won't be able to retain talent."

The MFAA has suggested upfronts may increase to 1.1% in response to the abolition of trail, but even if this did happen, it would put the 'client for life' mentality at risk.

"If there is a higher upfront commission, for example, that would help, but I'm concerned this would change it into a transactional relationship versus an ongoing