Submission to the Inquiry into Financial Products and Services in Australia

The role of financial advisers;

There is a misconception (public and unfortunately within some sectors of the industry) that the role of a financial adviser is to sell financial products. This is wrong.

The role of a financial adviser is to help his/her clients define and achieve their financial goals (short, medium and long term) in an efficient manager taking only necessary and acceptable risks. This is achieved by constructing appropriate strategies with consideration to relevant tax, legal and personal considerations and by recommending an appropriate asset allocation. And, importantly, though the constant review and modification of financial strategies to ensure they remain relevant to changing legislation and personal circumstances.

Please note that asset allocation is important. Product selection is not. The fact is that over time, different managed investments using the same asset allocation will tend to achieve the same results over the longer term. The key is in getting the strategy and the asset allocation correct.

The financial adviser's role is to help their clients manage their financial affairs in a smarter manner than they would have done themselves.

When this is finally understood, intelligent debate can take place.

This role is an enormous position of trust and responsibility and should always be taken seriously.

There are two considerations to remember however:

1. Financial advisers are **NOT** not-for-profit organisations, nor are they subsidised by the government. They are private citizens and business owners who have families of their own to support. Financial planning is their career, and like any other person out there, they need to take money home at the end of the day. And like any other business, their survival is dependent on making a profit. Rent, staff, operating expenses, insurance – these all need to be paid as well. Without this, the business fails and you can not advise and support a client if you are not in business.

   Industry "cowboys" and the greedy aside, the vast majority of financial planners I work with are successful because they actually do care about their clients and take a great deal of pride in successful outcomes. In actual fact, one of the common problems I find is that of 'over servicing' : great advisers with failing business because they are not charging the clients the real cost of initial and ongoing support and advice, let alone allowing for profit margins.

2. Tightening restrictions in an indiscriminate manner has one adverse outcome to be remembered. The cowboys – who did not follow the rules in the first place – continue to flout them, while the compliance costs of doing business rise for the good financial planners (of which there are many). So what happens? Consumers who have been taught by ignorant media beat-ups to base their decisions on price go to the cheap cowboy, deeming the high quality planner (with the high quality, high cost compliance processes and service offering) the greedy crook.

One last word on the role of the financial adviser. It is NOT to make decisions for the clients, but to provide them with recommendations and the information necessary to make an informed decision. In fact, the majority of reputable AFSLs disallow advisers to hold any sort of power of attorney or trading power for their clients.

Product v Strategy

A large AFSL did not collapse recently, seeing thousands of clients left in dire circumstances, because of product failure. The financial products involved where standard and fairly vanilla. The failure was a direct product of the **strategy** implemented for those clients.

The usual risk management strategies, employed by the majority of financial advisers, appear to have been discarded. It appears that clients were made to fit the strategy, rather than creating a strategy to fit the unique needs of clients.

Gearing always involves risk and can be an entirely appropriate strategy for some people (but not all). Good and appropriate strategy means managing that risk by ensuring appropriate reserves, times frames (no retirees for one), risk profiles, diversification, cash flow, consideration of alternative strategies (such as superannuation) and recognition of market cycles. And gearing should only be used when necessary to achieve goals, not just to make more money. It is the strategy that failed, not the product.

And the strategy would have failed whether clients paid $54 or $54,000 for the advice.

The general regulatory environment for these products and services

Regulation only works when people are honest. The crooks weren't following the rules in the first place, so why will they take notice now? One might even argue that regulation has made it HARDER for consumers to understand the financial products recommended to them.

Why? Have you read a product disclosure statement lately? They are long. The average person will not read such a long document.

State the risks clearly UPFRONT. Leave the mumbo jumbo for the back of the document.

the role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;

Bias

Absolutely, commission-based bias occurs. But it is the minority of financial advisers, not the majority to whom this applies.

10% upfront commissions on agribusiness products sound absurd. But amortised over the ten to fifteen year term of these investments, the ongoing revenue is around 1% pa, standard ongoing charges within the industry. In addition, only recurring revenue is used in the tradition method of valuing financial planning businesses, so the sale of these investments actually reduces the sale value of the adviser's business as opposed to the use of a traditional managed investment with ongoing client fees. Please also remember that these investments were sold in the majority by accountants. But of course, they are above reproach!

Disclosure

Disclosure and transparency are so important. The question is not how much clients pay or how they pay it. The question is DOES THE CLIENT UNDERSTAND THE COST TO THEM and ARE THEY GETTING VALUE FOR THAT PRICE? (not a bargain but value)

A client with $100,000 invested paying a $1,000 pa fixed fee or a 1% trail is still paying $1,000. What matters is that the client understands the adviser is paid this $1,000, that it is directly or indirectly charged back the client (via invoice or increased investment MERs). What matters is that the client is being reviewed annually and receiving fair value for that cost?

Then again, a cynic might ask why the car dealer down the road, the sales assistant in the mobile phone shop, the property manager at the rental agency or the personal lender at the bank are not required to provide details of any product restrictions, conflicts of interest and commissions they are paid?

And on that note, perhaps the journalist should be required to disclose when they are merely regurgitating industry fund press releases rather than writing an **independent** and unbiased article? Unfortunately, too many Australians take the uneducating whinging of some poor quality media professionals as gospel. A review of financial services journalism is well overdue. I have read at least two articles this week in which journalists have clearly provided general product advice without any appropriate warnings to seek advice. And in both situations, I could quickly identify several scenarios where poor Joe Average taking the advice in good faith could very easily get burnt. Would anyone hold the journalist responsible? After all, they were giving advice and failed to highlight the need to consider personal circumstances before making and decisions.

<u>Affordability</u>

At the risk of sounding indifferent, I don't care how financial advisers charge their fees. I really don't. What I care about is what they do to earn that money and that they make sure their clients understand the costs. Value and disclosure.

Before outlawing the payment of adviser fees via investment, please remember that in doing so you make financial advice unaffordable for so many Australians. As discussed earlier, financial planning companies need to be profitable in order to provide high quality and appropriate ongoing financial advice to their clients. They also need to meet the high costs of compliance, PI insurance and ongoing training.

Not all Australians are asset-rich or financially educated and they need help to make their goals a reality. For some people, having advice fees deducted from investments or super is the only affordable option. Again, the important part is that they understand what they are paying and believe that they get fair value for it.

Also be aware, that the more regulatory restrictions you place, the higher the compliance cost to businesses and, as a result, good quality financial advisers will need to increase fees to keep pace with these increased costs. The regulator needs to take some responsibility for the high cost of financial advice in today's environment.

<u>Value</u>

I know there are financial advisers in Australia receiving trailing commissions for clients they have never met, let alone review regularly. And I agree that to strip the passive revenue from these persons is no bad thing for the industry.

But remember the baby when you throw out the bathwater folks. There are also plenty of advisers who review their clients regularly and receive the entirety of their income as trailing commissions either through legacy or because it is the best outcome for their clients. What happens to these guys if trailing commissions disappear overnight? They go out of business and their clients are left without financial guidance.

Instead, please consider creating some system of accountability for servicing clients. This may be a register whereby advisers are required to sign off that they have met their minimum service commitments for a client annually (just like a soft dollar register). It may take the form of a statutory declaration, or an audited record, even a file note. Perhaps it becomes the product provider's responsibility to collect this confirmation from the adviser each year.

Again, it is not a matter of what is paid or how it is paid, but how it is disclosed and how value is provided.

If I pay $500 for an inexperienced adviser to place me in a strategy that results in increased taxation, high risk and little return, that is not value. If I keep on paying him $500 a year and never hear from him/her, that is not value either.

But if I pay $5,000 for an experienced and conscientious financial adviser to place me in a strategy that saves me tax, accelerates my wealth, reduces risk, protects my assets, that is value. Particularly if he/she takes the time to help me understand the what, why and how.

If that same adviser charges me another $3,000 a year (via invoice, trailing commission, whatever form) and provides me with an annual review of my strategy, recommends changes with legal and tax reforms, helps me to adjust my strategy when I get a pay rise, buy a house, have a baby, change careers, and creates an additional $100,000 wealth than the $500 adviser, that is excellent value too.

It is not price but quality of advice and value that are at issue here.

All I know is that to rule out trailing commission is a knee-jerk reaction to a real problem that requires a much more considered solution.

The role played by marketing and advertising campaigns;

I have little comment on this as advertising is sufficiently restrictive now. My only comment here is that there needs to be a clear distinction between the provision of a financial product, and the provision of personal financial planning advice.

A retail or not-for-profit industry fund provide a financial product. They make no consideration to the personal circumstances and aspirations of a client. They are no more than a financial commodity.

A financial adviser provides personal financial advice that takes into consideration the needs and objectives of their clients. They make use of said retail or NPF funds to help the clients meet their objectives, and the strategies for contributions, asset allocations, insurance needs etc. within these funds are where the real outcomes are achieved.

Both the fund and the adviser are necessary. For a fund to advertise itself as being cheaper than advisers is like comparing the price of a car with the price of an orange. Completely unrelated and irrelevant.

The result of this irresponsible advertising is the de-education of Australians in understanding their need to get strategies right. It should be illegal and the funds should be ashamed of the dis-service they are doing their clients.

The adequacy of licensing arrangements for those who sold the products and services;

Good character needs to be a major consideration in providing an AFSL in addition to the current requirements.

Consider differentiating financial advice from financial products. Advice does not always relate specifically to products.