29th June 2009

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600, Australia

Dear Secretary,

I am a Financial Adviser; I have been involved in the industry since 1996 and have been involved in the industry's evolution from its infancy to its presently evolved state.

Very early in my career I resolved to obtain my own **ASIC Dealers Licence**, primarily because I didn't want my client's financial outcomes subjected to external interference from financial institutions over which I had little control.

After reading many of the submissions you have already received I feel sincere regret for the devastation caused to the clients of Storm Financial by their practices. Further such tragedies are sure to follow if sales practices similar to Storm's are not stopped. The model they used is still being applied by other businesses and institutions. Some sales people, masquerading as Financial Advisers, tend to confuse "bling" with reality and pass unrealistic expectations onto their clients. The general public expect, and are entitled to believe, that the title "Financial Planner" means just that. Recent history however shows that many Financial Planners are no more than product or scheme pushing sales people with little expertise and even less commitment to their clients' wellbeing. I remember **David Maister (a leading consultant to Professionals)** telling an accountants seminar, "that consumers can't distinguish between good or bad accountants. They think that if the shingle says "accountant" then one is as well qualified as the next. They do however know the difference between and accountant and a lawyer, and expect different advice outcomes from each".

I will start my submission by giving an example of a product directed sales ploy that is being used by large dealer groups currently.

Example:

<u>Mr & Mrs Example have purchased a new home</u>. The Solicitor involved in the transaction says that the purchase is a big financial responsibility and as such recommends a company "Finance Experts Pty. Ltd", a representative of S.I.P. Clients attend an appointment with F.E and are asked leading questions such as - Would you like to own your home earlier? Retire earlier? And so on.

Of course the answers are yes! It is suggested that a plan be produced that will show how these goals can be achieved, cost $500.00 very inexpensive. Plan is presented and shows that if they invest into the stock market they can achieve their goals. The problem for Mr and Mrs Example is they have no investment funds available; they are of course very interested in the outcomes but cannot see how they can be achieved.

It is suggested that some funds can be obtained by increasing the home loan, the initial loan, the remainder can then be borrowed using a second loan, and the second loan is via a margin lender…, double gearing. Furthermore, they are advised that the loan repayments can be offset by tax deductions and dividends from the proposed investment. All in all things now look achievable, cost effective and possible all with no initial investment funds.

The investment product for investment into the stock market is a "Which Bank" managed fund, suggested for simplicity and management. This all looks great, they can own their home earlier, projections are exciting, Can receive some government assistance via tax deductions on the gearing. The Planner even states the market is ready to go up because it has gone down so much; the excitement of achieving the home ownership goal blinds them to any downside possibilities.

All the right Forms for compliance are filled and signed by the Hopeful home owners, Pages of stuff needed so the process can start, none are read and understood.

Of course it is disclosed that solicitor is receiving commission for referral and:-

- The Fee to be paid to the Planner's firm is 7% upfront, now all based on geared amounts!
- And most disturbingly that the fee is not paid by the client but from the product provider, leaving the client to believe that this is their lucky day, someone else is paying the fees.

Now let me expand what has just happened. The client believes that there is no cost to them for this transaction, the PDS for the product states that the adviser will be paid from the provider of the Financial Product, the referral from the solicitor is disclosed, and their goals of early home ownership seem to be a reality. Good outcome?

The Planner of course has taken a client with **no** real investment funds, convinced them to add to their home loan, and then added more debt via a margin loan. Viola, the adviser could now be investing $500,000 or more and getting $35,000 or more in commissions, the lawyer gets his cut so he keeps referring. All parties are now happy. Oh, I forgot one thing; the Planner's Firm will also receive trails on this arrangement of 1.75% p.a. on top of the product provider management fees.

What has been outlined is a true scenario, this practise has been mentioned to ASIC but no compliance issues seem to appear, practise continues today. Has this helped the client? It might but most likely the downside is more probable than the upside. If one does the calculations, this scenario shows any future market correction will probably mean that the client will have more debt, no future tax deductions if the margin loan is recalled and higher monthly payments. If on top interest rates were to rise then home ownership will be threatened quite the opposite of the desired outcomes when this scheme was first suggested. None of this is sufficiently highlighted in the optimistic Statement of Advice.

So how can some of these practises be stopped:-

1) Up front Commissions are banned on all products!

   or

   a. Since all commissions come from client funds, PDS should read, 7% of **your** funds will be paid to the adviser; this payment comes from **your** investment and will reduce the amount of **your** money invested.

2) No commissions can be paid to Planners on amounts invested by geared means on Managed Products. ie: No scaling up the reward to the Planner for gearing!
3) Advisers cannot pay other Professionals for referrals.
4) These types of operators should be distinguished from other Planners and be labelled like “product sales people” or some other distinguishing name.
5) Products such as Nil entry fee with exit fees that pay commissions should be banned, they are designed to be deceptive, and in fact take the fee out up front.

It does not take a genius to work out that the above would have meant Storm would not have done what it did, however the horse has bolted, let’s stop the next round.

Other:-

I have maintained that individual licensing would serve the community better than corporate Dealer /Distribution Group type licensing. Any professional will protect their ability to earn an income.
Under the current system many advisers work for large organisations, promoting company products with the belief they are doing what the company requires and the company will only do what is compliant by law. We now know that the Big end of town has served consumers very poorly, they have not operated on what is best for the consumer but what is best for the shareholder using their resources to take a minimalist approach to sound Financial Planning . Very simply, looking after the shareholder is very different to looking after the client, I believe the two are mutually exclusive.

If individuals are licensed we can have a true professional approach, P.I must be obtained by the individual, and insurers would not cover unethical individuals. Most importantly I believe ASIC needs to consult industry participates and gain a good understanding of what is and isn’t good practice. Perhaps working groups similar to what was introduced by the ATO would be a good start.

Unfortunately we have an industry that has been designed by product manufacturers, many of the untruths of investing have come from these product producers. In Australia nearly 80% of Advisers are licensed under the big product providers, many consumers don’t realise when they get advice from the big institutions that the advice is limited to or preferenced to that organisations product. For instance the banks have products that they own badge under different names, MLC, Colonial, BT just to state a few.

There is no way that we can legislate for ethical behaviour; legislators cannot protect consumers from making bad choices. The emphasis must be on allowing consumers to make decisions based on distinguishable modes of practice. One will not expect to get accounting advice from a lawyer; good financial advice cannot be had from a product salesman.

Ian Bailey