

# **INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA**

## **BACKGROUND**

It is extremely upsetting, sad and unfortunate that so many trusting investors now find themselves in such financial difficulty and emotional stress, having invested with every expectation that they were being steered in the right direction then finding, through no fault of their own, that their strategies have either blown up in their faces or have been negatively affected by a devastating Global Financial Crisis.

Many financial advisors receive payment for their services via upfront and ongoing commissions paid as a percentage by fund managers and life companies.

The recent collapse of organisations such as the Storm Financial Group, Westpoint and products like Great Southern and Timbercorp has raised concerns throughout the community over the appropriateness of the advice provided by advisors. In particular these concerns have centred on the possibility that some rogue advisors are providing advice that is weighted to maximise their commissions. This possible rogue behaviour has had a detrimental effect on the reputation of the wider financial advisor community.

To prevent advisors taking advantage of their clients, the concept of banning commissions is being considered.

There is an equally compelling argument that the purging of these rogue advisors from the industry would be a far more successful strategy resulting in improved investor confidence whilst professionalising our industry.

The recent Storm Financial Services debacle should never have been allowed to happen and I hope that my submission helps put mechanisms in place that contribute to preventing situations like that ever happening again.

My submission consists of issues currently affecting our industry and my 15 point constructive suggestions on possible improvements as to how Statements Of Advice (SOA's) are audited and assessed, in the hope that inherent problems with advice given could be identified PRIOR to investors injecting funds into strategies consisting of inappropriate advice or, unsuitable strategies.

## **AIM**

The aim of this submission is to present a more transparent method that better regulates the appropriateness and reasonableness of advice provided by advisors, in an effort to help safeguard investors from losses. This strategy will have the additional benefit of improving the understanding and appreciation of the role of advisors and cement their place in the workplace as professionals.

## **CURRENT VIEW TOWARDS ADVISORS**

While the overwhelming majority of advisors are honest, hard working professionals, the reputation of the industry has been adversely affected by recent events. In particular the failures of Timbercorp and Great Southern, and the aftermath of the Storm Financial Services debacle and Westpoint have unfairly painted all advisors in a negative light. There has also been a huge amount of attention given to "The Value of Advice" provided by advisors. There can be no doubt that financial advisors are currently in the limelight and in the front line of negative attack.

All professions have their 'bad apples' and it is inappropriate to tar the whole industry when a few of their members transgress.

The reality however is that the majority of advisors are focused professionals who, in addition to providing financial advice also build long-term relationships with their clients. The mortar that binds these relationships together is a culture where information and advice can be openly exchanged, trust developed and respect shown between parties.

Developing this relationship may well involve many draining and emotional hours of counselling, consoling and contributing to clients' emotional well being. These relationships are vitally important as there is a direct relationship between a client's financial well being and the circumstances of their lives at any given point of their life cycle stages.

Typical challenges, often unpaid, facing advisors include dealing with clients with the following personal Life Cycle Circumstances:

- Clients who have just suffered the loss of loved ones, including children
- Clients dealing with children hooked on drugs
- Clients undergoing particularly nasty divorces
- Clients whose children or family have stolen their inheritance entitlement
- Clients who have lost their jobs or gone bankrupt
- Clients dealing with blended family difficulties
- Clients whose retirement investment has been decimated because of the global financial crisis etc.

The valuable service that most advisors perform and deliver is in many instances impossible to value or quantify.

The majority of clients benefit from the support of their advisors and respect the role they perform. It is not always just about the value of their advice but also the importance of the valuable client/advisor relationship.

## WHY DO PRODUCTS AND/OR COMPANIES FAIL?

**Fact:** Never has a financial product, investment company or life insurance company failed as a result of the advice given by an advisor to an investor.

**Fact:** Never has a financial product, investment company or life insurance company failed because an advisor was paid commissions.

To fully understand the role that an advisor plays and their possible contribution to client financial hardship resulting from product or company failures, we need to first analyse and understand what causes products and companies to fail.

There are several possible reasons why investment products and/or companies fail including:

- Flawed business model of the product and/or the company
- Fraud, dishonesty or theft by the principals or employees of the product provider
- Mismanagement by those in day to day control of the product provider
- Unforeseen and unpredictable external Global events
- Ill advised decisions or bad judgement by those in day to day control of the product provider

There are, of course, also instances where an investor could have a legitimate claim against an advisor for losses suffered resulting from the failure of a product or the supplying company, where for example:

- That advice could be shown to be negligent, flawed or inappropriate to the client's needs and/or situation

- Where it is evident that there has been a blatant disregard by that advisor of the correct disclosure and/or compliance procedures
- Where the advice was inappropriate in the first instance

Examples:

- Advisor disregard to client risk profile or correct asset mix
- Inappropriate borrowing levels
- Too heavily relying on one particular product or strategy
- Some such blatant failure of duty of care on behalf of the advisor
- Incompetence, lack of training and lack of experience

## **HOW COULD INAPPROPRIATE ADVICE BE DETECTED BEFORE INVESTORS LOSE THEIR LIFE SAVINGS?**

Advisors could and should be held accountable where, for example:

- There has been a clear failure to make full disclosure
- The advice given is inappropriate
- There are irregularities with the underlying motivations that determine product selection
- Where compliance requirements have been breached
- Where the Advisor has been incompetent

Currently, there is no obligation to audit or report on either the appropriateness of the advice given or, the strategies and products recommended, **PRIOR** to the implementation of that advice.

Whilst the more compliance conscious Dealer Groups may vigorously audit these issues as part of their normal auditing process, this is usually done **AFTER** the business has been placed. This means therefore, that Dealer Groups are only auditing post implementation for strategy and appropriateness of advice related breaches, and not prior to implementation of those recommendations. This means that inappropriate advice may only be detected after the fact which could in some instances lead to financial disaster for those clients.

In addition, there may well be some conflict of interest issues relating to a Dealer Group auditing its own advisors. After all, those auditors are paid employees of the Dealer Group and their impartiality and independence could be tainted or compromised by virtue of their accountability to their masters. Of course, I am not implying that this is in fact happening at all, merely that it is possible, particularly with Dealer Groups who may be seeking to act improperly.

I submit that if the auditing process included an assessment of recommendations **PRIOR** to implementation, where the actual advice, strategies and recommended products were assessed for appropriateness to a particular client, irregularities may be detected early and there could be far fewer investors putting their hard earned life savings into unrealistic strategies and/or products fraught with danger and unrealistic expectations. This would result in a far lesser experience of financial stress and devastation when some products and/or companies ultimately collapse.

The process of recommendation assessments prior to implementation would also highlight any advisor's or Dealer Group's disregard of appropriateness. For example, if SOA's produced by Storm Financial Services had been impartially assessed for 'Appropriateness Of Advice and Strategies', prior to the investments being placed, the pre-emptive assessments may well have identified possible problems relating to appropriateness, highlighting a need for intervention.

Corrective measures could then have been implemented prior to investors injecting funds into inappropriate strategies, thereby perhaps averting losses of millions of investor dollars and uncovering, in this instance, possible inappropriate advisor behaviour **BEFORE** the fact.

## ADVISORS USE OF APPROVED AND RESEARCHED PRODUCTS

It needs to be said that all of the abovementioned failed products and companies, enjoyed the ‘green-light tick of approval’ by either ASIC, Independent Researchers, in-house Dealer Group Researchers and some products enjoyed ATO Product Rulings.

In light of the above, and taking into account advisor obligations relating to ‘Reasonable Basis’, ‘Know your Client’, ‘Know the product’ and Disclosure rules etc, it should be reasonable for an advisor to feel comfortable including those products and/or companies, which had enjoyed the benefit of prior vetting, into appropriate recommendations within a complying SOA.

## MY 15 POINT PRACTICAL SUGGESTIONS SUBMITTED FOR CONSIDERATION

- 1 Whilst audits should continue to be conducted after implementation, I propose that the **recommendations section only**, within SOA’s should be assessed **PRIOR** to investments being placed in an attempt to capture any problems relating to appropriateness before losses can arise.
- 2 These assessments of strategies and recommendations should concentrate on the:
  - A. **APPROPRIATENESS OF ADVICE GIVEN**
  - B. **REASONABLENESS OF RECOMMENDATIONS MADE**
  - C. **SUITABILITY OF STRATEGIES TABLED AND**
  - D. **PRACTICALITY OF PRODUCTS SELECTED.**
- 3 There should be an independent assessment body (IAB) formed to conduct the above recommendation assessments within SOA’s before any implementation takes place.
- 4 This independent assessment body should be made up of skilled and experienced CFP advisors who understand strategies and should be able to identify potential problems with advice given, strategies tabled and products selected.
- 5 This body should be paid and accountable for their work.
- 6 All industry participants including but not limited to: Fund managers, Superannuation Funds, Industry Funds, Life Insurance Companies, Research Houses, Advisors, ASIC, FPA, AFA, IFSA, Dealer Groups etc, should all contribute into a fund designed to:
  - A. Pay for the services of the independent assessment body
  - B. Help initiate mechanisms designed to weed out bad advisors and
  - C. Create a sinking fund available to compensate investors who may have been let down by the Independent Assessment Body. The amount of contribution to be decided upon through a process of consultation and discussion by the industry.
- 7 This fund should be managed by an independent Trustee.
- 8 Investor complaints arising from matters relating to recommendation assessments should be heard by a panel which includes experienced CFP advisors as experts.
- 9 SOA’s affected by inappropriate advice, unreasonable recommendations, unsuitable strategies and/or impractical products should be immediately reported and dealt with by either, further training or punishment, depending on the nature, repetition and severity of the underlying problems.
- 10 Consistent inappropriate advice by any Dealer Group or advisor (such as could have been detected if Storm Financial Services clients had the benefit of having their SOA’s assessed before making the decision to invest) should attract immediate attention and be dealt with appropriately depending on the nature and severity of the situation and should be handled by either additional training or punishment.
- 11 CFP’s should be afforded the respect and recognition they deserve from the regulators as well as from the public, the press and the industry at large.
- 12 The industry needs to become a profession as soon as possible with CFP’s leading the way.
- 13 CFP status should be compulsory before one can become an Authorised Representative and advice should only be given by CFP’s.

- 14 One should have industry experience with a CFP for a specified period of time before one can become a CFP. This would mirror some of the current requirements of other professions like Accountants, Doctors and Lawyers.
- 15 CFP accreditation should be designed with tougher entry requirements to include a period of 'on the job training' or apprenticeship with a CFP and penalties for transgression should be severe and act as a meaningful deterrent.

## **RESULTS OF IMPLEMENTING MY 15 POINT PLAN**

- **Investors would enjoy a higher level of protection because any SOA's with inappropriate advice should be picked up and acted upon prior to investing.**
- **The Financial Planning Industry would be one step closer to maintaining higher professional standards and quality control.**
- **Inappropriate advice would be identified and acted upon before it has a chance to cause horrific damage to investors as well as the industry.**
- **Bad/incompetent advisors would be less able to operate their schemes and scams undetected over long periods of time.**
- **Dealer Groups, whilst they may be inconvenienced by these recommendation assessments, would have a better 'hands on' understanding of what their advisors are doing and future costly law suits and claim settlements, relating to inappropriate advice, would be dramatically reduced.**
- **The industry at large would be putting substantial funds in place to help fund the assessment exercise.**
- **The financial planning Industry would take a positive step towards being recognised as a profession.**
- **The financial planning industry would move closer to self monitoring and self regulation which is imperative to be a true profession.**
- **It would be much harder for bad advisors to be unreasonably swayed towards consistently using one particular strategy or product over another without being found out.**
- **CFP's would enjoy a higher degree of rightfully deserved respect which is currently sadly lacking and long overdue.**
- **Audits and assessments would have far more meaning and carry much more weight.**
- **Public perception of and confidence in our industry would be far more positive thereby creating a confident environment where Australian investors can seek badly needed Financial Advice with a higher degree of comfort.**
- **Incoming new advisors would have a more structured method of being inducted into their chosen profession whilst being trained by experienced CFP advisors thereby raising the bar of competence, ability and respect for ethics and professionalism.**

## INVESTORS DO HAVE CHOICES

Investors who have been given a complying SOA, (as is required by law) **should** by definition, have all the information needed with which to make an intelligent and informed decision about whether to proceed or not.

A complying SOA should include, but is not limited to, the following:

- Clients current financial and family situation
- Clients issues and problems
- Clients needs, goals and objectives
- Recommended Strategy/ies
- Recommended product/s
- Research
- Full disclosure of fees, charges and commissions
- Advisors' reasons for strategies and products and other information as is clearly laid out in the current regulations

At this point, investors have some valuable choices available to them.

They could:

- Accept and act on all or part of the advice and recommendations given
- Take the SOA away to read and digest over time
- Get a second opinion
- Seek alternative advice from an alternative Advisor
- Talk to their Accountant and/or Lawyer
- Reject all or part of the advice and recommendations given
- Research for themselves, the companies and products recommended
- Make sure they have read the SOA completely in the first instance
- Request further information from the Advisor
- Any other action the investor wishes

In today's climate, where our industry is so heavily regulated, it would be very unusual for an investor not to be receiving complete written and complying advice with full disclosure etc.

If they have not received a properly constructed and compliant SOA, then there is something systemically wrong with the way in which that advice has been given and an appropriateness assessment, such as I am proposing, would help identify and pre-empt any concerns early enough to avoid disappointment.

If they have received a properly constructed and compliant SOA, and all the required criteria have been met by the advisor, then there needs to be some responsibility and accountability taken by investors for the decisions they ultimately make.

Clearly, if a product purports to give an unreasonably high return with very little risk or, promises an unachievable pot of gold then, investors need to be able to take a step back and have a second look.

Perhaps investors could go to ASIC or the FPA for some input (if such input were available from those entities) or seek an independent opinion from another professional Advisor or body such as the new assessment body I am proposing.

The 'greed' and 'fear' factors should be well and truly dealt with and eliminated before investing and replaced with a better understanding of the strategies and products employed so as to avoid any 'after the fact' disappointment.

If it looks too good, sounds too good and challenges common sense, the investor has the choice to just walk away.

It must also be emphasised that the vast majority of Advisors in Australia are hard working, honest and ethical people whose sole purpose is to try to help ordinary Australians and not hurt them.

## **COMMISSIONS**

The uninformed outside observer who looks only at the time taken to design, present and implement an SOA, and shouts from the roof tops that "commission is a dirty word and should be banned", simply has no real grasp about what it is that advisors actually do nor how much positive impact the overwhelming majority of advisors have within the community and the vital functions that Advisors perform.

Many outside observers have no idea of exactly what advisors do. The current method of payment, via upfront and ongoing commissions paid as a percentage by fund managers and life companies, is a most convenient method of receiving payment.

Banning commissions is not going to stop bad advisors giving bad advice nor curb them from taking advantage of their clients and giving inappropriate advice. Getting rid of bad advisors is the only sure way to stop those bad advisors giving inappropriate advice.

I have been shocked and dismayed at some of the recent negative press propaganda, most of which has been misguided, ill informed, ignorant and infuriatingly generalised in its approach.

It is about time that we as an industry start pushing back and publish some of the many wonderful life changing positive results we have managed to achieve for most of our clients.

Banning commissions is more likely to cause greater unnecessary costs to investors because commission oriented advisors would now have to invoice clients, send statements and collect their fees. Many would have to employ additional staff to co-ordinate their fee and debt collection thereby causing even greater costs. Advisors might well have to start charging for each and every phone call, postage, meeting, contact and transaction in order to recoup those costs.

Investors could end up being worse off by having to pay fees higher than the commissions currently paid to advisors. A lot of what Advisors do is unpaid.

In addition, and this is more to the point, banning commissions would not rid our industry of bad advisors nor reduce the amount of bad advice given. It would simply cause bad advisors to employ more creative methods of charging for that bad advice. We need to identify and expel those bad advisors and negating commissions would simply not do that job.

Contrary to some of the submissions I have read, there are very few advisors charging maximum commission rates and only a few rotten apples are being tempted and seduced to push certain products based purely on commissions.

Agribusiness products, which usually run for over 10 years and pay a 10% upfront commission, have attracted some bad publicity. It must be remembered that these products do not pay any ongoing annual trail commissions and are therefore cheaper over a 10 year period than other investment or superannuation products that pay 1% upfront commission and a 1% per annum trail commission measured over that same 10 year period.

For most advisors, it is never about the products selected, it is always about the strategies employed. The information and intellectual property that an experienced advisor possesses and is willing to pass on to their clients is extremely valuable and should be respected and deserves to be paid for.

I note with interest that many advisors linked to particular organisations (like some of the Banks) are restricted to only support associated 'in-house' or 'sister company' products. Surely this lack of product choice carries serious diversification disadvantages for investors and flies in the face of what FSR and subsequently introduced regulations attempt to achieve, which is to create a level playing field and give investors higher protection and wider product and fund manager choice?

We live in a democratic capitalist society where the buyer chooses and decides who they wish to deal with and how much they are ultimately willing to pay for the service, product or benefit they enjoy.

If an advisor, in the mind of the investor, is charging too much, then the investor should either, negotiate a better deal or, shop elsewhere.

By having the benefit of recommendations and strategies assessed by a highly experienced team of CFP advisors, **BEFORE** investing, investors would have one more layer of protection by knowing that, whilst products and performance cannot be guaranteed, the quality and appropriateness of the advice they have been given is sound and appropriate to their needs at that stage of their life cycle.

This submission consists purely of the opinions and views of the writer and has been made in good faith in an attempt to bring respect and reason into an industry to which I and many other advisors have devoted our lives.

We love what we do. We love our clients and we value the long-term relationships we build with our clients. We deal with our client's problems daily, we take their problems home with us each night and we do everything in our power to help them solve their problems, live a better life and achieve more financial goals having had the benefit of our advice and their relationship with us.

I feel sure that advisors collectively feel that our hard work and efforts are often disregarded by an unkind media and consequently the positive impact we have on so many Australian's lives is too often ignored, undervalued and taken for granted. I am amazed at how disjointed our industry actually is. We do not speak with one voice which results in disunity and infighting. This is unproductive and dilutes our power.

I fear that advisor best interests are not always fully represented or protected by those who purport to represent us and we are more often than not, let down and unfairly left carrying all the responsibility and blame. I call on all involved parties within the financial services industry to work more closely together, without private agendas or egos, in an attempt to bring our industry into repute with professional status and to help bring cohesion to an industry that does an immense amount of good for so many ordinary Australians.

As a CFP, with over 33 years of industry experience, training and education, I resent being lumped into a "catch-all" basket of disrepute so easily meted out by those who have very little understanding of or appreciation for what the vast majority of honest, caring and hard working advisors in Australia actually do each and every day, with their client's best interests constantly at heart. I sincerely hope my submission has a positive impact on these proceedings and I would be pleased to discuss my views with any official representative or forum.

I thank you for the opportunity to table my concerns, observations and suggestions and I look forward to your positive, swift and meaningful recommendations.

Paul Levy CFP  
Authorised Representative