



## Hayden Financial Services Pty Ltd

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The Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
Department of the Senate  
PO Box 6100  
Parliament House  
Canberra, ACT, 2600

Attention: Dr Shona Batge – Committee Secretary

Dear Dr Batge

**Submission: Parliamentary Joint Committee on Corporations & Financial Services –  
Inquiry into Financial Products & Services**

Please find enclosed our submission to your Committee's Inquiry into Financial Products and Services.

Hayden Financial Services Pty Limited ('HFS') holds an Australian Financial Services Licence (AFSL 239062).

Please call or email me to discuss any aspect of this submission.

Yours Sincerely

MARK HAYDEN  
BEc, DipSM, DipFP  
Certified Financial Planner  
Director

**Background on the Author - Mark Hayden**

Mark Hayden started in the industry in 1979 working for a large Insurer and undertaking actuarial studies. He later changed to obtain an Economics Degree and worked in Corporate Super before leaving the Insurer in 1995 to commence Financial Planning. The goal was to be independent (not influenced by a Fund Manager) and to cover more than just super (incorporate other client needs). He advised under a small and then a large Licensee before getting his (his company's) Dealers Licence in July 1999 and AFSL in November 2003. He has set-up and unwound two joint ventures with Accountants and is convinced his model of staying small (ie one Adviser plus one support staff member) is the best for him and his clients.

## **Executive Summary**

### **Transparent Fees/Services Requires Three Distinct Divisions**

This submission recommends that the Financial Planning industry be segregated into three divisions that provide very different services, require different skills and provide different risks to consumers and the community as a whole. Legislation needs to address the three divisions and PI insurance can be structured to provide appropriate protection for the risks involved.

The three areas are explained in detail in Section 1 below and are:

- A. Advice (in relation to the consumer's needs)
- B. Investment Selection/Management (the actual investing)
- C. Administration/Trustee Services including Custodial roles

Transparency of both the service provided and fees charged will ensure competition to improve services and/or reduce fees, clear definition of the service contracted by the consumer and reduced costs of production of the service via specialisation and transparency

There cannot be payments between the entities. The focus is to provide the best result for consumers through transparency and a consumer focus.

- Platforms should not treat Advisers as their client and/or their distribution arm (their advertisement/marketing is effectively paid by the end consumer),
- Industry/Corporate Funds should provide transparency on Administration and Investment choices and fees, and
- SMSFs should ensure competition reduces administration fees for "standard" funds (eg incorporating shares, term deposits and managed funds).

The segregation and the resultant competition and transparency will result in:

- Less clips-of-the-ticket between the Investor and the Investment (eg BHP shares)
- Lower costs in all sectors of the industry – admin will have parts commodotised with resultant savings; investment fees will be payable only where value-add exists; Adviser fees will have less compliance costs built in
- Attracting more high quality people to all areas including Advice
- Retain the large number of good professionals in the industry – albeit some of their roles will change
- Better overall investment outcomes for consumers as investment managers compete on their skills rather than the size of marketing budget or attachment to a platform or fund

Unbundling the services and fees will be a win for consumers, legislators and the industry professionals.

This submission will define these three divisions, consider the risks involved – ie what could go wrong - and what Licensing is required. It will address the issue of extra work for legislators.

This submission also addresses the issue that Advisers should be Practitioners rather than Businessmen.

Appendix A shows in Flow-Chart form the three Divisions and the lines of interaction.

## **1. Defining the Three Divisions of Suppliers of Services**

The range of services provided for consumers in the Financial Planning area should be split into three distinct groups as follows:

- A. Advice (in relation to the consumer's needs) – The Adviser works with the client/consumer to determine their goals and the recommended means to achieve these goals. The services include structure and strategy matters such as superannuation, pensions, Family Trusts, savings strategies, gearing strategies etc. The services also include asset allocation matters, covering all the asset sectors and sub-sectors. In Defensive assets the Adviser may recommend Term Deposits or Fixed Interest Fund Managers. The Adviser would also recommend and advise how to access (but not place) individual investments within these asset sectors; in Australian Shares, for example, the options may be an Index Fund; specialist investment Managers (a Fund Manager or a LIC -Listed Investment Company) or choosing your stocks, via the consumer doing their own research or via an Investment Adviser who selects those stocks.
- B. Investment Selection Matters- This is the actual selection of individual investments. In Australian Shares it may be a Fund Manager or a LIC (Listed Investment Company) or a person/group that is contracted to select individual stocks (a Stock-broker or, under current terms, a Financial Planner authorized to deal in ASX stocks).
- C. Administration/Trustee/Custodial Services – All areas of record keeping and, in super, the Trustee responsibilities. It covers the appropriate placement of investments and implementation of insurance. This area can be split between Custodian roles and pure admin roles.

There should be no payments between each group as they should compete on their merits.

An important issue is this Model (ABC Model as above) segregates the recommendation of investing \$x in Australian Shares and the actual selection of which individual shares are purchased. These are different skills.

## **2. Licensing the three divisions**

Legislation via the Corporations Act can provide strict parameters and also ensure competition is allowed to flourish (to improve services and costs). The Corporations Act would need amending to define these three Service Providers and importantly, the subsets of these divisions as below:

### A Adviser Licence

A1 – General Adviser – eg advise on structure matters, asset allocation matters and only recommend certain products - eg sections B1 to B3 below.

Other Advisers will be Specialist Advisers – eg :

A2 – Non-traditional asset sectors and derivatives

A3 – Able to recommend Investment Managers licenced under B4-B6 below.

A4 – Able to cover unusual areas such as non-resident income

A5 – Life Insurance

A6 – Abridged terms – eg Super Trustees; product distributors (ie representing one product)

## B Investment Selection/Management Licence

- B1 - ADI products
- B2 – Other Fixed Interest Based Products – Bond Funds, Mortgage Funds etc
- B3 – Products with no/minimal chance of permanent loss of capital - Traditional Asset Sectors – eg Standard Aust Shares Fund – 20 or more stocks covering a range of industries – hence, very little, if any, chance of it being worth zero
- B4 – Traditional Sectors but chance of permanent capital loss – eg insufficient diversification
- B5 - Alternative Asset Sectors
- B6- Sophisticated Products

## C Administration Licence

- C1 - Admin Services
- C2 - Trustee Services
- C3 - Custodial Services

An advantage is that an Adviser does not need to waste time and resources learning an area he/she will never want to advise on – eg A2-A5 above – as the Adviser can refer customers to a suitably qualified Adviser. A lot of time and resources are wasted on non-core-advisory areas and this cost is eventually worn by consumers.

Persons or entities that provide services in a range of areas – eg an SMSF Company that provides full service - will need to be Licensed in all areas.

An Adviser who also selects direct shares for their clients must clearly define their service and fees and be Licensed as Advisers and Investment Managers – eg under A1 and B3 above. This will provide transparency and clarity for the consumer and remove confusion when the advice is x% to Shares and y% to BHP – ie they are separate recommendations.

The potential confusion for consumers of these sub-licences may not be significant if, as per Appendix A, most consumers will use A1 (or A6) and the Adviser (or Super Trustee etc) will then be the main contact (face to face) with the consumer.

This submission will mainly focus on Advisers (where I have experience etc) but briefly address the other areas.

### 2.1 Discussion on Requirements for Advisers

The Licencing requirements need to cover:

- Barriers to entry –Barriers to Entry need to be able to keep out unprofessional Advisers but should not keep out good Advisers. Educational requirements are essential. Monetary requirements are not – see Capital Adequacy below.
- Education and Qualifications Required
- Required Standards of recording the advice provided
- ASIC’s role in monitoring and the penalties involved
- Required levels of PI insurance
- Capital Adequacy and PI insurance are required to address restoration of unreasonable losses. PI is the best way. We do not expect Medical Practitioner’s to hold large amounts of capital but we do expect they hold large levels of PI cover. If capital adequacy is seen as a cure-all it will suit businesses rather than Practitioners (section 4)

Legislation should also encourage the industry to continually improve standards and strive for world-class performance.

## 2.2 Proposed Licensing Structure for Advisers (especially General – A1 – Advisers)

Each Adviser to be Licensed. If two or more Advisers share a Licence then one or more people are concerned with Licensee matters (businessmen focused matters) rather than Adviser matters (Practitioner matters). A Licensee has a conflict via a responsibility to share-holders or owners. The Licensee will provide at least some direction for the one or more other Advisers and this must influence the action of the Adviser/Practitioner.

Time spent on business related matters are often not of value to the consumer. An Adviser can pool services with other Advisers but the revenue to that Adviser should be directly related to the services provided to, and the fees paid by, the consumer.

A Practitioner should never have sales targets nor product incentives. The “advice” is the service and he/she should be remunerated for that.

## 2.3 Registration – eg via Financial Planner Registration Board

The downside of needing individual Advisers to be licensed can be partially addressed via using a Financial Planner Registration Board.

This will address registering and de-registering Advisers. Immediately on being de-registered an Adviser will have ceased meeting the Licensing requirements.

Ideally this Board will be separate to the Professional Standards Board as below.

## 2.4 Professional Standards Boards (PSB)

The Board should consist of Practitioners and be elected by Practitioners. Its charter would be to maintain and improve the standards of Advisers.

The PSB should play a major role in the area of fees. One role is to set limits – eg an Adviser cannot justify charging more than, say, 1%pa for low-balance investors and no more than, say, 0.5%pa above a certain limit. This can be determined by both the maximum reasonable value-add to the investor (see the section on fees below) and the reasonable cost to produce.

The PSB would focus on ethics and integrity and set standards for the client-relationship – see also Section 4 below.

### **3. What can go wrong with each Supplied Service and how can the consumer be protected**

When a consumer obtains a “bad outcome” we need to consider what went wrong. The areas that may cause problems are:

- Inappropriate strategy – eg excessive gearing
- Incorrect asset mix – ie for customer’s stated goals – the PSB would play a major role here (eg standards that show what are reasonable ranges of strategies in relation to the consumer’s stated goals).
- Fund can be worth zero –responsibility could rest with the Advisers or the Investment Managers or both to ensure the customer understood this risk. Certain products can only be recommended to consumers by a Specialist Adviser (A3-A5). Hence these Specialist Advisers would need specific PI Cover.
- Lack of skills of Investment Manager – eg Licence terms under B1-B6 will address requirements
- Fraud
- Untimely delays in processing – eg applications and redemptions
- Insufficient diversification – eg a portfolio of 5 stocks of which 2 go into liquidation. The consumer may have said for this part of their net wealth they want a speculative portfolio and instructed the Adviser and Investment Manager of this goal...or the Adviser may not have advised of the risk of substantial loss...or the Investment Manager may have advised (eg in PDS) of a different process of investment to the that which eventuated.

The products recommended by the Advisers will have different risks and these can be segregated – see section 2 – eg if Hedge Funds are recommended then there are clearly higher risks. An Australian Shares Manager with 20+ stocks covering a wide range of industries is unlikely to have the investment become worthless.

Market risk – not an Investment Manager issue – the Adviser is responsible to ensure the Consumer understood market volatility

#### 3.1 PI Cover

PI Cover should be specifically related to the risks involved and should provide reasonable levels of restoration. The risks involved will vary depending on the services provided.

PI Cover levels can be set for the following sub-divisions:

- A1 – General Adviser
- A2 – Non-traditional asset sectors and derivatives
- A3 – Able to recommend Investment Managers licenced under B4-B6 below.
- A4 – Able to cover unusual areas such as non-resident income
- A5 – Life Insurance
- A6 – Super Trustees and Product Distributors
  
- B1 - ADI products
- B2 – Other Fixed Interest Based Products – Bond Funds, Mortgage Funds etc
- B3 - No/minimal chance of permanent loss of capital
- B4 – Traditional Sectors but chance of permanent capital loss
- B5 - Alternative Asset Sectors
- B6- Sophisticated Products

- C1 - Admin Services
- C2 - Trustee Services
- C3 - Custodial Services

PI cover should actually reduce for A1 Advisers (and hence their investor's fees) because the consumer can be appropriately educated on market risk and the other factors that could go wrong, as above, are minimised.

### 3.2 Capital Adequacy

Capital Adequacy should be set at a minor level for General Advisers (A1) as there is minimal risk of permanent loss and the PSB and Licence terms should ensure all Advisers are appropriately educated. Capital Adequacy should not create a barrier that excludes good people from becoming Advisers.

Please see comments in section 2.1 regarding capital adequacy and practitioners such as Medical Practitioners.

## **4. Practitioners Rather than Businessmen – the ideal Advisers.**

If Advisers are both seen, and act, as Practitioners rather than businessmen that will be a win for consumers. A businessman must think of his business needs and related services whereas a Practitioner is engaged in a profession and focuses on consumer care (eg along the lines that Medical Practitioners focus on patient care).

Professional Standards Boards are crucial in any profession. The Board would consist of Practitioners and will be more active and attuned than Legislators and/or Watchdogs to potential problems in their profession. The goal of such a Board is to maintain and lift the standard of the profession.

The sub-dividing of Advisers for Licensing purposes will help ensure the Adviser can spend the majority of their time on the areas that will provide most value to their clients. If a General – A1 – Adviser they can spend more time on those crucial matters and provide higher quality of service whilst referring out other areas of Advice where needed.

Compliance requirements reduce the time available for an Adviser to spend on Practitioner related matters.

## **5. Fees**

By isolating the service provided by a Supplier it is then easy for consumers to compare the quality of that service.

The best way is for market forces and healthy competition to determine fair levels of fees. This has not been the case for a couple of reasons. Firstly, buyers (consumers) have not had access to a lot of market information as the information they have received has often been provided by representatives of the sellers.

Secondly, the legislation has encouraged overcomplication of all areas – Statements of Advice (eg 80 page ones) have added to costs but not the quality of services; SMSFs have had fees built into the admin process that incorporate complexity; Wraps have overcomplicated the services needed etc.

### 5.1 Adviser Fees

In an ideal world fees are set by:

- i. the value-add (to the consumer) and
- ii. the cost (time) to produce (by the supplier).

The PSB could play a role in setting reasonable fee ranges (see Section 2.4).

Setting fees on a time cost basis is not appropriate for two reasons: - a 10 year investor will have some years where they require more hours than other years; - apportioning a cost, eg for research of “x” hours per year, across all consumers is not necessarily logical from their perspective – eg as soon as a new customer is added the Adviser’s hourly rate should drop for existing customers; and if he loses a customer can he adjust the hourly rate back up?

Asset related fees can be part of the fee structure for Advisers and Investment Managers because there is an extra value-add but this does not apply for Administrators.

### 5.2 Investment Manager fees

Transparency and competition would reduce fees as the professionals are paid for stock-picking and portfolio skills rather than custodial services or transaction services.

### 5.3 Administration fees

Transparency and competition would reduce fees especially in the area of “standard” SMSFs (eg incorporating shares, term deposits and managed funds).

## **6. Other Matters that would change**

Below are some related matters that need consideration in the changes :

Volume Overrides – these would be banned. A justification of volume overrides is that Coke is cheaper at Woolworths than the corner shop. I, as an Adviser, recommend Coke but I do not say you need to buy “my” Coke, you can buy it at Woolworths; ie I am an Adviser not a Distributor.

Shelf Space fees would not exist as in this ABC Model as there cannot be payments between Administrators and Investment Managers. This is a positive as Investment Managers will be selected for the “right” reasons rather than the size of their (or their parent company’s) marketing budget.

Soft-dollar incentives between any of these 3 entities must be limited to ensure the integrity of the industry. Many industries allow significant marketing and entertainment allowances but, because of the nature of our product (investments) it is reasonable to have limits.

Cross Subsidisations - these should be eliminated or minimised as they do not encourage efficiency with suppliers of services. The complicated SMSFs make standard SMSFs more expensive. Cross-subsidies also apply with Corporate/Industry Funds and with Wraps/Platforms.

Higher than necessary PI cover for say A1 Advisers can be a form of cross-subsidisation. eg A General Adviser would have minimal chance of causing undue losses (eg permanent loss or unreasonable in terms of time frames etc) for a consumer. Specialist Advisers would have higher chances and hence need higher PI cover and the higher premiums for this cover should be paid by the Supplier (Adviser) and passed onto his/her consumers if it is a reasonable cost.

The Vested Interest in Overcomplicating Matters – There is little benefit to consumers as a whole where overcomplication or over-servicing applies. SMSF admin and audits can overcomplicate the basic requirements. Platforms and Wraps have lots of bells and whistles that are frequently not needed.

Consumer Education - The key education requirement for a consumer is to be able to contract a suitable practitioner (which could include website support and/or super fund support). A consumer does need to understand the laws of physics explaining why a building or bridge will not fall – they need to understand and be assured that the Practitioner (Architect and/or Engineer) have the required skills and experience.

Distribution Agreements – should not exist. See the Coke story above. Currently an Adviser who wants to recommend a specific Investment Manager sometimes needs a distribution agreement – even though he is not distributing the product, he is simply recommending it. The Adviser is providing advice and his focus is on the consumer not the product manufacturer.

Transactional Capabilities – should be improved for managed funds such that they can be purchased and redeemed as easily as ASX shares.

Life Insurance Cover – competition and more information flows to the public of recommended minimal levels of cover would be positive for consumers.

## **7. Conclusion**

Legislation needs to be quite clear in what is expected from suppliers in A, B and C and also in terms of the protection provided for consumers but it also needs to ensure there is competition and hence that market forces will provide benefits, via lower fees and better service standards, for consumers and for the community as a whole.

By defining what services are required in financial planning and segregating these into three distinct areas it is possible to create good legislation and reasonable levels of protection for consumers.

# Appendix A

