19 May 2009

Mr. Bernie Ripoll
Chair
Parliamentary Joint Committee on
Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir,

I would like to contribute the following thoughts to your committee's "Inquiry into Financial Products and Services in Australia".

I have seen the industry from several different perspectives. I began as a commission focussed planner for one of the big providers and almost left the industry shortly after as I couldn't reconcile the conflict between what I saw as my duty to provide advice and my employers requirement that I sell a certain amount of product. I'm not anti-sales, even as a fee-for-service adviser I am selling all the time, I sell the value of my services and then I try to convince (sell) my client into implementing whatever I believe is the best solution for their needs. Doctors do the same thing; a professional and ethical salesperson does too.

The key difference between a doctor and a salesperson (professional or otherwise) is that a doctor has a fiduciary duty to act in the best interest of their client, a salesperson does not. Again, a professional and ethical salesperson will act in the best interest of their client but they are not legally obliged to do so. The vast majority of consumers, when they approach, or are approached by a salesperson (whether they have a law degree or not) are acutely aware of the fact that it is the salesperson's job to try and sell them something. They are likely to conduct their own research and apply their own intellect before making a decision to follow the salespersons recommendations, much more so than if the same recommendation came from a trusted adviser. So what do people expect when they talk to a financial adviser?

Clients come to financial advisers for advice (makes sense really). We are assisting them with complex issues that are immensely important to them and about which they often have only a peripheral level of understanding. We also charge fees. Within this current grey area in which we are currently operating, even many commission advisers are charging a "fee" for their service. Whether it is commission disguised as a fee or a flat fee for preparing a statement of advice this is likely to reinforce the client's expectation that they are paying for advice. Of course, even if there is a product being sold the client is also likely to receive additional non-product related advice as part of the fee being paid, a potential benefit to the client but likely to further confuse the issue.

All fees, commissions and conflicts of interest are required to be disclosed to the client but if the average adviser-client meeting went for say 90 minutes, how much time do you think is spent building trust and rapport, presenting strategies and projections, selling, and how much time is spent on disclosing fees, commissions and conflicts. I would suggest certainly not enough to erase the work the adviser and the advising industry has done to ensure that the client suspends their buyer beware mechanisms at the door of their "trusted adviser".

Unlike a doctor we have no legislated fiduciary duty to the client. We have an obligation to "know the client" and we also have an obligation to provide advice which has a "reasonable basis". There is of course no requirement to provide "best" advice but a client seeking advice would at least be expecting their financial adviser to give the best recommendation that the adviser (as a trained and qualified professional) can come up with following careful consideration.

Unfortunately, whether it is on paper or just in their head, the conflicted adviser is likely to rank the options on some balance which combines their client's needs with their own. An ethical adviser may be almost exclusively focussed on the client's needs. An unethical one will be focussed almost exclusively on their own. In reality most professional advisers are probably conflicted in this manner to some degree. Even if they just have a personal interest in encouraging their client to continue to seek and pay for advice.

The big difference between financial and many other advice providers is that we come from a history of commission based sales. We've made small steps to reform our profession, but we are still living off a drip-feed of up-front and trail commissions, overrides and asset based fees. Dealer group profits are based on FUM, adviser remuneration is based on sales targets and some investment providers would go out of business if they were forced to compete on product and price rather than their ability to attract dealer groups (dealer groups? shouldn't that be adviser groups?).

The first principle of the FPA's new code of ethics enforceable from 1 July is "Client First", a requirement to place the client's interests before anybody else's including the adviser and the adviser's employer. This is a step in the right direction, as is their recommended move away from commissions by 2012. Unfortunately it is not enough. Not all advisers are members of the FPA, their recommendations have been contested by other industry bodies such as the AFA and it does nothing to eliminate the current practice of simply re-badging a commission as an asset-based fee (which still gives the adviser an incentive to recommend gearing to increase the FUM and hence the fee, aka Storm Financial – for example).

Money Management (30 April 2009) quoted a survey from CoreDate which suggested that "28 per cent of respondents who currently have a relationship with a financial planner are 'very likely' to consider not using a planner at all in the future." This is obviously related to market conditions but we are not doing ourselves any favours. We can no longer refer to "a few bad eggs" and expect the general public to forgive the rest of us when the biggest problems are inherently structural. We need to make significant changes and soon.

I would suggest the following measures for your consideration;

- Financial advisers must be regarded as having a fiduciary relationship with their clients, they must put the client's needs before their own or those of their employer. If they are unable to do this then they should refer the client elsewhere.

- As per the Puzzle Financial submissions, beyond "know your client" and "reasonable basis" advisers should be required to provide "unbiased, unrestricted advice based on a comprehensive and fair analysis of relevant markets". It is otherwise too easy for an adviser to fall back on a limited approved product list which is structured around the adviser's needs rather than the client's.

– No commissions or alternatively delineation between advisers and salespeople. Salespeople are either BDMs that work for the product provider or agents (outsourced BDMs) that are engaged to sell product on behalf of the product provider. Advisers are engaged by the client to provide advice designed to help them achieve their objectives. Financial advisers are licensed by ASIC to both "deal" in and "advise" on financial products. The distinction already exists at a high level but more needs to be done to remove sources of conflict between the two activities.

There may be no legislative recourse but I would suggest that the committee makes recommendations towards the advising industry and the industry super fund network that they put down the knives and start working together. Currently we have the ridiculous situation where two of the biggest professional, supposedly non-competing groups in the industry don't even talk to each other. Once financial advisers shift from sales to advice focus they should begin to acknowledge that industry funds can make substantial contributions to the financial well-being of many of their clients. As for the industry funds, they do understand the value of advice, and it is not their core competency, so remove the commission issue and they should become more conducive to interacting and making it easier for their members to interact with non-affiliated financial advisers. The best funds and the best advisers finally working together would be a huge win for the Australian consumer.

Achieving this would require more than just removing commissions. One distinct benefit offered by the retail funds is the ability to pay for advice from otherwise preserved superannuation balances, either via commissions or fees deducted directly from the account. Industry funds do not generally permit superannuation advice fees to be deducted from individual accounts except to be paid to an associated advising service (such as Industry Fund Financial Planning – another conflicted adviser). In our experience most clients are much more likely to pay for superannuation advice where the fee is paid out of their account. This is understandable considering that they may not able to access the funds under advice for many years. The fact that this could make their clients more likely to pay for advice may result in advisers continuing to have a bias towards the higher fee retail funds, whether they are paying commissions or not. It would therefore be in the interest of advisers, funds and fund members for there to be a compliant mechanism by which all members can pay advice fees out of their super account.

There are other reasons why advisers and the industry funds don't tend to get along such as a lack of adviser centric reporting available from the industry funds. The commissions/fees issue however is by far the biggest concern for both parties (ignore financial advisers who tell you it isn't) and overcoming this would likely be followed by a big shift in attitude from both sides.

There are clearly some fundamental changes to be made in the way we do business and there are going to be a lot of problems along the way but there are already advisers that are working on creative solutions to these problems. I believe that once the industry as a whole shifts focus from selling product to providing advice we'll be amazed by what we can accomplish (and so will our clients).

Thankyou for your time spent in considering my thoughts on this matter. Any assistance that your committee can provide in helping our industry to shift in the right direction would be greatly appreciated.

Yours sincerely,

Daniel Hicks
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