

19 May 2009

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
P O Box 6100
Parliament house
CANBERRA 2600



Dear Sir/Madam

Submission to Parliamentary Joint Committee

I wish to present the following submission to the Parliamentary Joint Committee investigation the Financial Services Industry. My submission follows:

I believe the problem with the financial industry is one of focus. That is, the focus is not on the client's interests but is focussed on the interests of the collusion between the various financial institutions and financial advisors. Change the focus onto the client's interests and the problem will solve itself.

In support I submit the following

- Financial advisors receive remuneration for the sale of financial products to clients. At the same time and for the same transaction, they receive remuneration from clients in relation to these same products. This represents a conflict of interest and this is not in the best interests of the client. Is the advisor providing the best product for the client or providing the one that provides the best commission to himself? In fact it is a quasi "pyramid selling" operation with client referrals encouraged and rewarded.
- Advisors are tied to only one area of the market – unit trusts, as this is where they derive their income. This is why they do not want clients to invest in other areas of the financial market such as property, cash and direct shares. In my case I have been advised to get rid of property to invest through my advisor and also the issue of leverage to but more units has been raised.
- The more the client invests through the advisor then the more income the advisor derives. This creates greed and supports their desire for clients to leverage to buy into these products.
- Generally the markets work in a cycle with some areas up while others are down. Clients want to be able to move between these markets to take advantage of opportunities whereas advisors seem to argue against this because they do not get commissions from these other areas (Direct cash, direct shares and property). The commissions paid to advisors effectively deny clients access to other investment areas.

- The financial products are designed to contain a mixture of products, fixed interest, international and domestic shares, property trusts etc. This is shown in a pie chart. The problem is that it is impossible to withdraw say the cash component without selling the whole pie. The pie chart analogy is correct as the various components can be likened to the flour, water, salt etc in a pie. It is impossible to get the salt out of the pie. This effectively locks in clients into a single product and thereby does not allow clients to move within investment areas. It also locks in the commissions to the advisors.
- There is no tie between the performance of the client's fund and the remuneration of the advisor. It follows then that the financial advice given need not be the best advice for the client as there is little or no impact on the advisor.
- The focus for the advisor is in the sale of proprietary products not the performance of the client's fund. Until this is changed there will never be any surety for the client.
- When the crash came both in the 1990s and in this current case, the advisors did not inform their clients on the possible consequences of the looming crisis so that clients could make informed decisions in relation to their portfolio.
- When the crash came, even in the early days of the crash, clients were advised to ride it out, notwithstanding that financial opportunities existed in other areas of the financial market. For example in the 1990s crash, the market fell but property was booming but no advice was given to move to that area that would benefit the client. Instead advice to ride it out was given. This is not in the clients interests.
- There is no feedback to clients other than at annual seminars or monthly newsletters. The markets operate on a daily basis with all sorts of floats, merges etc going on that represent opportunities (and risks) for clients. Information from advisors is not timely or proactive. I would suggest that this is not in the client's best interests nor does it comply with clients expectations in receiving proactive timely advice from their paid advisor.
- In this current crash, advisors are more interested in selling products to the next crop of investors rather than looking after the interests of existing clients. It could be argued that the financial sectors strategy is to lock in existing clients ("you need to ride through the crash, super is a long term investment, don't sell as you crystallise losses", and so on) so they can concentrate on harvesting the next crop. ("there has never been a better time to invest, the markets are at historical lows", and so on). This strategy is not in the best interests of clients.

I believe the answer to the financial industry issues requires only two changes to the system :

1. The companies selling financial products should pay their commission to the client – not the advisor. This ensures the companies have to provide the best

product for the client to purchase. It will generate real competition between institutions and higher performance products in the best interests of the client.

It will also remove the conflict of interest issue from the advisor as he will receive no income other than that derived from the client – as it is in all other commercial areas. It therefore brings the financial industry into line with the rest of the commercial sector. It also encourages advisors to seek opportunities in other areas of the financial markets to maximise client opportunities and hence their own remuneration.

2. The advisor should derive all of his income from the performance of the clients fund. That is, his remuneration is tied to the performance of his client's fund. This will provide incentive to communicate opportunities and risks and manage and nurture the clients fund. My suggestion is that there is no up front percentage fee at all. This removes the 'sign up and forget" possibility. I suggest the remuneration to the advisor is in the following parts;

Part A: An annual fixed fee to cover basic overheads (not wages). This is a very small amount (% of portfolio) such that it is not a replacement to the commission and provides no incentive to forget the client. This fee should mainly cover professional indemnity insurance for the advisor so that aggrieved clients can seek compensation through the legal system.

Part B: A percentage fee of the **profits** generated by the advisor. All wages etc will come from this so that advisors can employ staff on commission. Losses in a client's portfolio will result in a Negative "fee" which will be applied as a credit towards future fees. This will ensure that the focus of the advisor is firstly to avoid losses by giving timely advice and also to proactively work to shorten the length of downturn for his client so that BOTH can prosper in the long term.

Summary.

At present the system is not geared towards the investor's interests. The system is packaged to benefit the advisor and the institution by the way the products are designed and marketed. This needs to be changed .

Client's believe that they pay for professional advice and expect the advisor to be proactive on their behalf. This is not the case. Making the advisor reliant on the client's success will ensure only good advisors survive in the industry and that the best outcomes for all the industry is ensured

Given that it is the client's money that makes the whole system work, then it is common sense that his interests take precedence. Removing the advisor from his position between the institution and client is essential. Advisors should only be linked to the client.

Products should be designed to be more flexible so that components can be moved without penalty to take advantage of market fluctuations. After all, the market is a

very flexible entity and products should therefore reflect this. A revamp of the types of packages presented is essential.

It is all about focus on the client's interests. If these are met then performance will be enhanced and this will encourage more people into the industry and the institutions, advisors and clients will all prosper as will Australia.

Should you require any additional comment in relation to this submission, please contact me at the above address.

I request your consideration of this submission.