

PARLIAMENT of AUSTRALIA – JOINT COMMITTEE

Inquiry into Financial Products and Services in Australia

Reference Points:

- 1. The role of financial advisers.**
- 3. The role played by commission arrangements relating to product sales and advice, including the potential for conflict of interest, the need for appropriate disclosure, and remuneration models for financial advisers.**

To help the Committee understand my comments, I will refer to my own financial structure and circumstances in relation to reference points 1 and 3.

BACKGROUND

My partner and I established our own self managed superannuation fund on our retirement from full time employment in 2005. Our fund was established with the assistance of a registered financial adviser. The fund consisted of Australian equities that we selected, and cash invested in bank term deposits that we arranged. We sought advice from our financial adviser regarding investment in an overseas equity fund and we took his advice and made an investment on his recommendation. Our financial adviser also recommended an Australian unlisted property fund called APN Property for Income Fund No.2. All these products were examined by me and I was made fully aware by our financial adviser that trailing commissions applied and he would have an ongoing income stream. Toward the end of 2007, my partner and I became concerned that the Australian share market was overvalued, world economies were slowing and the U.S. sub prime issue had not been resolved. As a consequence, in December of that year, we sold our entire share portfolio and invested the funds in bank term deposits where they currently remain. We did not discuss this decision with our financial adviser.

We were in Europe in early 2008 and on our return in February we immediately sold our overseas managed funds. We did not discuss the selling of these managed funds with our financial adviser. At that point the APN investment had lost 23% of its value since 31st December 2007. I contacted our financial adviser and proposed that we sell out at a loss and place the funds in a bank term deposit at 8% with the knowledge that the interest rate cycle was on the rise. He advised that we should remain in the Fund as it had been oversold and that if we switched to cash we may miss the capital rebound. After a short discussion, my partner and I decided to take a loss on the APN investment; we sold it on 4th March 2008 and placed the funds in a bank term deposit. Between 31st December 2007 and 31st May 2009, the APN investment lost 64% of its value. To further complicate this investment, all redemptions were frozen in October 2008 and as at June 2009 remain frozen.

CONFLICT OF INTEREST

Having reviewed this event, I am left with only one conclusion – that it is totally unacceptable for people providing financial advice to be the direct beneficiaries of that advice through payments from the providers of financial products. The questions for us are: did our financial adviser suggest we hold APN because he genuinely believed that the value of the Fund would “rebound”, or did he suggest we hold because he would be losing his trailing commission? Not only that, if he advised us to sell APN then he would be obliged to advise all his clients to take a similar course of action with potentially a substantial loss to his income.

It is abundantly clear that no investor should be left wondering in whose interest their financial adviser is acting, and the issue of disclosure does not alter this position. Investors cannot be confident of receiving impartial and independent advice if their financial adviser is receiving any form of payment for recommending a financial product.

FEE FOR SERVICE

The elimination of all payments to financial advisers by the providers of financial products is going to have a significant impact on the incomes of financial advisers. The only alternative is for financial advisers to be paid by an appropriate hourly rate. Obviously the hourly rate charged by financial advisers will have to substantially increase. However, the reassurance clients will gain by knowing that the advice they receive from their financial adviser is independent and impartial will be worth the additional cost. It is also worth noting that in most cases the cost of advice is usually only a very small portion of a client’s overall investment pool.

There are at least two other factors that support the fee for service option. Firstly, clients will be able to genuinely make comparisons in regard to the cost of advice from various financial advisers. In the current circumstances, financial advisers may charge a low hourly rate but have their income subsidized by the payment of commissions on products they recommend that are not necessarily in the best interests of the client. Secondly, the payment of an hourly rate affords some protection for the financial adviser from their clients. By that I mean that if a particular financial product does not perform to expectation then the financial adviser cannot be accused of recommending it purely for the purpose of gaining a commission. It then becomes an analysis by the financial adviser and the client of the appropriateness of that product.

If payments to financial advisers are made only on the basis of an hourly rate then there definitely needs to be legislation to prohibit the payment of secret commissions. I would strongly urge the provision of criminal penalties rather than civil penalties for both the financial adviser and the specific representative of the product provider for any breach of the appropriate Act. The deterrent effect of a prison sentence is essential to ensure that the payment of secret commissions is eliminated.

RECOMMENDATIONS:

1. Payment by clients to financial advisers for financial advice should be done on a fee for service or hourly rate basis.
2. Legislation should be enacted to disallow financial advisers from receiving any payment or inducement from the providers of financial products including direct cash payments, trailing commissions, holidays, dinners etc.
3. Both the financial adviser and a specific representative of the provider who supplied the payment should be subject to criminal charges.
4. The penalties for such a breach should involve a mandatory term of imprisonment.

I would appreciate the opportunity to present my submission in person at a public hearing of the Committee.

Norman Wills

11 June 2009