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Continuing fees erode nest egg, banker warns

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December 13, 2007*

PAYING for financial advice through continuing commissions is an "illusion" where people falsely think they are saving money, Ric Battellino, the Reserve Bank deputy governor, has said.

Mr Battellino also told a finance and banking conference in Sydney yesterday that people who avoided an upfront fee from investment advisers often suffered later as fees eroded their earnings. He said the current rate of compulsory superannuation guarantee payments at 9 per cent of income was unlikely to give an adequate income in retirement.

"Most of the recent research suggests that, to ensure an adequate replacement income in retirement, the current level of superannuation guarantee contributions will need to be supplemented by the old-age pension for lower-income households, or by voluntary contributions for those households not eligible for the pension."

Mr Battellino said government initiatives to encourage superannuation had helped Australia's funds management industry grow to be one of the 10 biggest in the world. Australians were more likely to make direct investments in sophisticated financial products, he said.

On the issue of financial advice, there was a general reluctance among Australians to pay on a fee-for-service basis.

"Instead, there has been a preference for commission-based advice, despite the conflicts of interest that can arise in this situation. This reluctance to pay for advice upfront appears to be a form of money illusion, whereby investors may feel that they are somehow paying less for financial advice if the cost is buried in reduced earnings in the future."

But Mr Battellino said financial advisers faced a fundamental conflict of interest in being paid commissions to recommend particular products.

"The question remains as to whether full disclosure is enough to deal with the potential conflicts of interest associated with commission-based fees, or whether there is merit in the industry moving further in the direction of offering advice on a fee-for-service basis."

The fact that so many investors had put their money into high-risk, unsecured investments like Westpoint showed better financial literacy was needed.

The Reserve Bank is responsible for the stability of the financial system, although the Australian Securities and Investments Commission sets and enforces rules for financial advisers.

This Story was found at: <http://www.smh.com.au/articles/2007/12/12>

