

In the business of advice, not of aggregation

The financial planning services model needs a radical overhaul, writes **David Price**

IT is fair to say that the image of the financial planning industry has taken a serious hit in the past 12 months.

Financial planners came in 16th on the Roy Morgan Image of Professions poll published this month, with just 25 per cent of Australians rating planners very high or high for ethics and honesty. This is the first time the profession has been included in the poll, so comparative figures for previous years are unavailable, but it is likely that recent tumultuous events have further eroded consumer confidence in the sector.

Storm Financial, a Queensland-based financial planning network, left a trail of destruction when it was placed in voluntary administration in January with client losses estimated at \$2 billion to \$3bn.

It single-handedly destroyed the lives of hundreds of clients and tarnished the reputation of the financial planning industry.

Then there was the collapse of Melbourne stockbroking firm Opes Prime in March last year, and the earlier collapse of the Westpoint property group, to name just a few, where more than \$1bn of retail investors' money was lost.

Ironically, however, these events could be the catalyst for industry-wide reform with far-reaching positive outcomes and a new emphasis on ethics and independence.

Although it provides little comfort for the clients of Storm Financial, Opes Prime and Westpoint, stakeholders from the top down are asking themselves the hard questions. Whose objectives are we truly trying to meet? Is the industry remuneration model of commissions flawed? What needs to happen to ensure the industry remains viable? And how can we best serve and protect clients?

In my estimation, 70 per cent to 80 per cent of industry members are standing firm on maintaining the status quo, preferring to have their advice valued by the commissions they receive from products rather than establishing profitable business models that are not conflicted and don't require a third party safety net.

But the remainder — backed by the Financial Planning Association of Australia and the Investment and Financial Services Association — are lobbying for the industry to evolve into a fee-based profession that puts the client, ethics, trust and transparency first.

The FPA has recommended that fee-based remuneration be adopted as

the standard model of payment for financial advisers from 2012.

While people should be free to choose how to pay a financial planner, removing commissions will dispel accusations of conflict of interest, FPA chief executive Jo-Anne Bloch says in a recent press release.

Payment for financial planning services should come from the client, not the product provider.

She says continuing the commission-based regime is unsustainable and acts as a disincentive.

Only three out of 10 Australians seek financial advice, she says.

The IFSA joined the call for change when it announced this month that it would launch a new charter on July 1 next year that will allow customers to negotiate the fees they pay for advice and to have the ability to control such payments for advice.

The new charter also stipulates performance reporting as an industry-wide standard, which hopefully will lead to the acceptance of reporting on a post-fee, post-tax basis as the industry norm.

Meanwhile, the issues surrounding the collapse of Storm Financial, namely margin lending and the related financial advice given to clients, are subject to an investigation by the Australian Securities and Investments Commission. Then there is the inquiry into financial products and services in Australia, which will deliver its recommendations to parliament by November 23 this year after it sifts through hundreds of submissions from industry members and the public.

The debate about commissions v fees is not about disclosure. It is a matter of public record that Storm Financial produced statements of advice documents that were compliant and included disclosure of all fees. That said, these documents failed to protect their clients and were so voluminous that it was unreasonable to expect customers to fully comprehend the complex nature of commissions, incentives and third-party payments mentioned.

And, unfortunately, the structurally corrupt nature of the financial planning industry and complicated nature of third-party payments means Storm Financial is not alone in the production of such compliant statement of advice documents.

The rewards of an industry-wide fee-based model, however, are numerous for the profession and, most important, the clients.

Clients will see the cost of services



Illustration: Paul Newman

drop because they no longer will have to subsidise the commissions and third-party payments paid discretely to the financial planners.

If you strip commissions from the cost of financial products such as managed funds, retail superannuation funds and personal insurance, the cost to the client falls by as much as 50 per cent a year.

A fee-based structure also would negate the need for the financial adviser to meet burdensome and expensive disclosure and compliance regulations, thereby reducing the time spent and the cost of advice to each client. These two factors alone will improve public confidence in the industry, which in turn will lead to an increase in clients seeking advice and a more informed and financially literate public.

This can only aid the retail investors

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and avoid future disasters such as the collapse of Storm Financial, Westpoint and Timbercorp.

My suggestion to those who argue for commissions is that they first ask themselves why there is such a strong correlation between commissions paid of 10 per cent to 12 per cent and the high risk-poor return financial products that have caused so much heartache for clients during the past two years. Second, they should review their own business models for evidence that their argument is flawed. That is, if you can't make a profit doing what you promote, which is giving advice, and your business needs to be subsidised through third-party payments, then you simply have a bad business model. To that end, all commissions must be banned on all financial products including superannuation, investment, mortgages and

personal insurance. Yes, even personal insurance, which seems to have been forgotten in this argument.

We at Strategy First Financial Planning rebate 100 per cent of all commission received on insurance products, which results in clients paying 30 per cent a year less for their premiums. Now, that may be a good way to solve the severe problem of underinsurance in Australian society.

Also, financial planners should not receive remuneration of any sort (salary, bonus, stock options or shares, incentive trips, subsidised training, research or rent) based on the volume of client money they direct into any one financial product or administration platform. Instead, they should be paid only by clients, with the amount, method of calculation and collection mutually agreed.

The client also must have the ability

to turn this payment method off if they are not receiving the level of service they were promised. The practice of receiving trail commissions from the financial products sold to legacy clients must be stopped.

And there should be a clear distinction between financial product advisers who are licensed through product manufacturers and financial advisers who hold an Australian Financial Services licence with no ownership links to product manufacturers. To take this one step further, in an ideal world of independent, fee-only advice, institutional groups such as AMP, Westpac, Commonwealth Bank and the National Australian Bank that manufacture products should be restricted from owning financial planning businesses.

In addition, AFS licence-holders should not be able to badge adminis-

tration platforms or have preferred product lists that result in them being paid volume rebates. Are they in the business of aggregation or advice?

This practice of negotiating rebates from wrap platforms and fund managers based on the volume of business that an AFS licence-holder sends to the preferred supplier is the newest and most insidious commission to infect the industry.

Under this scenario for example, the client pays 0.75 per cent for administration and reporting to a wrap platform such as BT or Macquarie, which, in turn, pays up to 0.4 per cent a year back to the AFS licence-holder.

This is an obvious conflict of interest and must be addressed. The most recent example of how such practices can skew advice is Storm Financial, which reportedly received a 0.3 per cent a year volume rebate from Challenger for the money it invested on behalf of clients.

So with a one-off 7 per cent upfront commission and a 0.3 per cent a year volume rebate paid on all money invested, arguably there was a strong incentive for Storm Financial and its advisers to encourage the use of Storm-badged products at the expense of other suitable options and for clients to take on substantial debt and consequently much more risk.

The present raft of financial service rules and regulations are about protecting those who may not be able to protect themselves, but they have failed miserably. Financial advisers have a great responsibility, and the first step in accepting that responsibility is to build an industry that is based on ethics and designed with the needs of the client first. This is simply not possible with a commission model.

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