



Conflicting interest – the great debate

THE ROUNDTABLE

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Kate Mulligan (KM), managing director, Advance Asset Management

Peter Bobbin (PB), partner, The Argyle Partnership Lawyers

Mark Schroeder (MS), head of wealth management, Fiducian Portfolio Services

Khaldoun Hajaj (KH), director of policy and research, Financial Services Consumer Policy Centre and consumer representative, Financial Industry Complaints Service panel

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Controversy over soft dollar payments and conflicts of interest are threatening the financial planning industry. Money Management invited some of the industry's leaders to hammer out the issues in a roundtable discussion.

MM: Has the controversy over soft dollar commissions and conflicts of interest in financial planning damaged the credibility of advisers?

MS: We're not hearing a lot from the public about this, a lot of [the discussion] has been internal. We've just had our annual conference and this was discussed in-depth. The feedback from the client base is minimal. I've got a feeling there's a level of cynicism about financial planners anyway.

I think it's incumbent we raise the profile of the good planners. Even the [Financial Wisdom court case] doesn't seem to have impacted, certainly on our business in terms of clients raising it as an issue.

PB: I am finding the advisers and the dealer groups are themselves feeling under a barrage of media spotlight, and they are feeling there is a widening credibility gap. Whether there actually is one in the marketplace – maybe there's less of a perception of that with the punter. But [advisers] themselves, I'm finding, are feeling

that in terms of the social rung, they really like the existence of used car salesmen because they're above them. But they're not feeling too far above them.

KM: We're seeing a time when the consumer has never had more power, and on the back of that consumerism, being as transparent as we possibly can be is very important.

The other thing I feel strongly about is the funds management industry getting behind financial planners. Because quite typically the sort of sponsorship we will be involved in, if you want to classify it as soft dollar, will be the sponsorship of an adviser having seminars to educate investors.

So I think it's very important when you consider choice [of fund], as it's coming up, if the advisers are not going to educate investors, I'm not sure who is.

RG: I think the combination of the Financial Services Reform Act (FSRA) and the advent of choice has put the blowtorch on the wealth management belly. And while I think the number of

consumers who have adverse perceptions...is relatively low, the industry cannot ignore the media and political comment surrounding its operations. And that's why IFSA has moved strongly [on this issue]...with the FPA. And I suppose if we don't act, others will act for us, and much more egregiously so.

In summary, criticism is small in terms of the impact on the radar, but in terms of perceptions of others, it's big. And those perceptions are the things that shape opinions, and often reflect an underlying level of commercial activity that may become a worry, and therefore we have to address it.

KH: The reason why there aren't a lot of consumers or clients making a lot of noise is that soft dollar and conflicts of interest are topics that are so incredibly complex.

So when we deal with issues such as rebates, soft dollar, commission, buyer of last resort, equity plans, salaried advisers versus commissioned advisers, and all those big picture issues, consumers quite often leave it up to others



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to actually come to terms with and understand better. On close analysis of those big picture issues, it becomes quite obvious that there is a credibility problem within the industry itself and the way it chooses to distribute its products.

Now there is a lot of noise being made out there from consumers trying to reinvent the wheel, the reality is that things are not that bad, but certainly the outcome of the shadow shopping program showed there were problems and those problems were quite urgent in some instances. But public perception certainly is one that sees planners as being very badly conflicted.

MM: Who do you think is at fault for this conflict of interest – advisers who take commissions or product providers who pay them?

KH: I think it is important to recognise what Louise Sylvan said 18 months ago – and I don't necessarily endorse Louise Sylvan's comments – which is that the industry is structurally corrupt. A lot of what Louise said there was taken out of context...but fundamentally, I agree with the sentiment. I think given that distribution of the products that are being offered by the money management industry as a whole relies very heavily on planners who themselves rely heavily on receiving commissions, and other hard and soft dollar inducements, it's inevitable that cracks will appear in the system.

Now unfortunately the cracks that have appeared in the system seem to be of the kind that induce planners or advisers to sell products to consumers that do not maximise the benefit to consumers...I think IFSA's, the FPA's and even ASFA's (Association of Superannuation Funds of Australia) work lately has shown that the industry is quite serious about tackling this, but as long as the system is structured on the marketing of products by commissioned salespeople, then inevitably people will do the wrong thing if the inducement is large enough.

So I think there's a joint responsibility that needs to be taken by the distribution people, the manufacturers and platform providers.

RG: It's important to recognise that every financial product, in fact, every product, is sold with the potential for conflict of interest. So there's no industry without conflicts of interest. Even the industry funds, which are what the ACA (Australian Consumers' Association) would probably call clean, have

their conflicts of interest, because they sell one product, and they sell it through a business development manager, who doesn't sell any other product to an individual. And the business development manager receives a salary and probably receives a bonus at the end of the year for doing well, and that's never mentioned, and probably never disclosed.

At the end of the day, I think the consumer movement will shoot itself in the foot if it doesn't allow [commission-based advice]. I think there's about 40 per cent of individuals who prefer to pay by commissions if given the choice. I think what is important is if you are doing it this way, and there is potential for conflicts of interest, they must be explained to the customer.

KH: While I think commissions are important, the issue is not commissions, the issue is whether they are properly disclosed, and I think I agree for small time investors, who are only just starting off with that first \$10,000 investment, paying directly is out of the question. Paying \$4,000 for a \$10,000 plan is patently absurd, that's why it's important to have a commission base. However, there is always an issue of how this commission is disclosed for honesty and transparency.

MS: If you disclose what you're doing and be clear to the client about what you're doing and why you're doing it, you can't be any more honest than that.

MM: Is disclosure an adequate solution, or is it an easy way out for the financial services industry?

CD: Certainly when [the FPA] started work on this whole issue we were probably ahead of a lot of the media and other reports that had come to the fore, certainly this year in the realm of soft dollar, so our thinking was ahead of that, but also in response to some of the criticisms that have been levelled at financial planners over the years.

And our motivation primarily was around lifting the standards and driving professionalism for our members, and to ensure that clients and potential clients actually knew how people were paid and what they were paying for.

So it is...a response to criticism over time about the lack of understanding, I suppose, of how the industry works.

PB: The industry is creating for itself a false safe haven...What some of this debate will do is make some sections of

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the industry and possibly also the public feel as though everything is alright now.

But what we've got now is little more than a compliance check box arrangement...What I'm finding is that some dealer groups, and not the professional dealer groups, but some, are using FSR as the cloak to say 'we're okay'. 'We have the sign-off by ASIC, and we're good to deal with'. And consumers will be burned as a consequence.

CD: It's not about disclosure per se, it's about acting in a fiduciary role for the client, and acting in the best interests of the client.

KH: While disclosure is very important, it's still of marginal importance when compared with consumer education.

The problem is, even if you tell consumers what a commission is, what a rebate is, what a soft dollar is, what an equity plan is, it will not make a huge amount of difference because the average consumer does not exist in an environment where disclosure is a common everyday thing...I've seen some of the PDSs and they're 100, 120, 130 pages, and they do have all the information that is required for the consumer to make an effective choice, but I don't think they are documents that are clear, concise and effective. Do they enable the consumer to really look for the key points that they should be for them to make an appropriate choice? I say they don't.

I've seen some PDSs that embed so much information they have confused the consumer who has just thrown their hands in the air because it's all too difficult.

KM: I agree completely with what Khaldoun is saying. I mean a 120-page PDS is ridiculous. FSR directs us to have concise disclosure, which 120 pages is not.

MM: The industry has responded to a lot of these issues with the recent FPA/IFSA code of conduct in relation to soft dollar remuneration, which bans some payments that are volume sales related and requires all others over \$300 to be disclosed on a public register. What was the thinking behind this code?

RG: We saw this as the major point of industry weakness in terms of conflict of interest, and it didn't take us very long to formulate what that code should be.

We were guided by the code that the members of Parliament have for free gifts they get, so that immediately gave us the dollar amount, and to some extent, gave us the notion that we should ban those incentives that are volume-driven. And it also drove the idea of the register, and the register is something the politicians use.

Interestingly ASIC wrote to us and said they didn't think the register was viable or do-able, and we said 'no, we don't agree with it, we're still going to do it'. And it's certainly a millstone around our neck to have to do it, and on January 1 next year I can see a flurry of press interest looking at what people have got on their register.

So there will be a lot of competitive interests at stake here, and a lot of media interest, and as the saying goes, sunlight is the best disinfectant, and this will be a good dose of sunlight.

MM: Is anyone likely to get burnt though?

“ I've seen some PDSs that embed so much information they have confused the consumer who has just thrown their hands in the air because it's all too difficult. ”



Kate Mulligan and Richard Gilbert.

RG: It's quite possible they will. I think there will be people who don't come up to scratch. And when they are rung about whether they have a register and they don't have one...then they're going to be embarrassed. And the boards of those particular funds managers/advisory companies are going to find it difficult.

PB: Are the FPA/IFSA going to out them? Are you going to out them or are you going to be afraid of defamation?

RG: A condition of IFSA membership

is that you comply with the IFSA standards and guidelines, and up to the extent that you don't comply with that one, you won't be a member...They will comply, they have to complete an annual compliance statement, which is completed by the boards of the funds managers.

And if the boards of the funds managers agree to a certain code of behaviour and they don't do it, I think ASIC would be interested, when they do their annual review of that company to find out whether it is being run with due diligence, to look at that.

MM: Will you chuck them out of the association if they don't?

RG: Oh yes, if you don't comply with the standards you can't be a member.

CD: Our point in putting the code together is that we expect that behaviours will change, and this is really the

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first step in an ongoing process that will see behaviours change in the industry to lift us to a profession, so it's one part of the overall plan that we have to improve the positioning of financial planners in the minds of consumers over time.

MM: How will the FPA act if one of its members does not comply with the code?

CD: One of the things we're doing as part of the follow-through now with the code is that we are having a number of implementation meetings, working meetings, and there is an oversight group that will be chaired by an independent person and have representation from FPA and IFSA on that, and it will review the implementation of the code, and will deal with issues around non-compliance.

The decisions around how we deal with members that don't comply, certainly our board is very keen to be able to publish those, but we have to look into whether or not we can do that from a legal perspective.

MM: Do you mean publicly outing those who do not comply?

CD: Yes, but whether we can do that is a different story. So that would be the

positioning that we originally started from, and we want to be able to demonstrate that we are implementing the code effectively...It is seen to be very much a strong part of the practices that we expect from our members going forward, and again one of the things that differentiates our members from other financial planners.

MM: In a recent letter to *Money Management*, an adviser said "the people who put this code together are so far removed from the day to day financial planning it is a disgrace". Is this a typical reaction to the code from the financial planning profession?

CD: To say that that response is typical is probably not so. We did get a range of responses from our members, some in a similar vein, but other people were quite strongly of the view that this is about time and we need to do more.

We had a number of people come back and say 'I think there should be more things on the banned list', and you've got to remember, as an association, we are representing all types of planners and all types of business structures, from small independent dealers to large corporates.

So we needed to make sure the policy was going to be able to be applied to all those people, without any unfair

bias for one group or another. We certainly felt we put it out for consultation and...we put the paper through every committee we could to make sure we got feedback.

RG: What we're on about here is the good of the whole profession and that is critical. The credibility of the whole profession of financial planning and wealth management is absolutely critical, and similarly we really had it in our minds that we wanted to make sure there was 100 per cent embrace [of the code].

MM: Will financial planners and dealer groups be able to implement the code?

MS: I don't think we have a problem with that at all. In one respect, we were once kind of back-handedly criticised for disclosing too much. I don't disagree with the principle and I don't think anyone does, what we want to do is be in an industry that provides advice to clients, and it's the quality of the advice that's more important to me.

If you can demonstrate there is an adviser out there that is heavily biased one way or the other, then that has to be resolved. So whatever is in the best interests of the clients not only makes good sense morally, but also commercially.

PB: In terms of the dealer groups and so forth that we deal with, every one of them will comply with the code because they recognise they must. But certainly the language we've been embracing is



Peter Bobbin

don't rest on your laurels simply by embracing the code because that is not managing the level of risk in the organisation.

KH: I think...it is quite a good code, but really it's not the detail of the code that matters, what matters is the enforcement of the code.

I think it's relatively fair to say that enforcement of codes by industry associations in general has not been particularly good, across industries – it could be aviation, it could be the medical sector, it could be the financial planning sector.

Self-regulation hasn't worked effectively, yet as a political scientist, I can actually say one of the most effective forms of regulation is self-regulation, because as Richard quoted earlier, sunlight is a great disinfectant, and I say that when you have a whole industry watching itself, then I do think they can regulate their behaviour in a far better manner.

So what I'm getting to is that I think there is enormous commercial value in having a thorough code that is enforced. To date I don't think there is much evidence of industry enforcement. If there is industry enforcement I think that has to be made public somehow, and I do realise there are certain laws that may perhaps prevent it from happening.

If the FPA or IFSA or whichever professional association is willing to get rid of a few members who don't want their name published publicly, then I think you can have a workable model that includes publication of names. Because I think without publication of names,



George Liondis

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without almost public shaming, then I think this code will be another very thorough code on paper and not particularly effective in reality.

KM: I make a point of going to dealer group conferences and meeting advisers wherever I can, and I was really surprised at the level of interest in this by financial advisers. Because this is on the back of FSR, so they've just been through a hell of a lot of regulation and compliance, and the last thing I thought I'd hear was advisers saying to their dealer groups, 'what are we doing about soft dollar?' and being really concerned with it...

If I can quote one of my colleagues in the industry who said he could count on the fingers of one hand the good financial planners he has come across, well in my 20 years in the industry I've met a lot of planners, and I could count on one hand the number of poor financial planners I've met.

MM: Is fee-for-service the answer for removing conflicts of interest from the financial planning profession?

PB: I find the debate about commission structures intriguing, because the argument is that people under fee-for-service automatically get through the conflicts. Yet in the legal industry fee-for-service, particularly the hourly rate fee-for-service relationship, is being expressed as being tyrannical, ineffective, inefficient and against the legal consumer's interest.

So we've got the legal industry which is downgrading and lambasting the fee-for-service approach, and we've got the financial services industry which is praising it as the answer to conflict.

Disclosure is not the answer to conflict – it's ethics, it's culture, and embracing a consumer centric and focused relationship inside whatever business model the advisory group has. It doesn't matter whether they have a commission-based model, a fee-for-service business model, a flat fee business model.

I can give you an example, very recently and post-FSR, of a person who accepted a million dollar upfront fee. I find it extraordinary. Full disclosure is there. You can't tell me that there is no motivation on the part of the advisory group to put that plan in place.

MS: I've personally wrestled with this one for some time because you know, both models have merits but both don't.

I'm getting back down to what the client finds most applicable for their circumstance.

I know of clients that just do not want to write a cheque every now and then. The fee-for-service people tell me they have a lot of difficulties. I know a practice in Melbourne that is all fee-for-service, and they have a lot of unhappy clients as a result.

So I circle around what's best for the client and what suits them the most. As long as you explain to the client, this is the process, this is how we're remunerated for giving you the correct advice, and the client can make the decision whether that is acceptable or not.

I don't think by using the word com-

mission there is anything secretive about it. If it's all disclosed, it's just a manner in which you're paid for giving advice so the client doesn't have to pay upfront, and the other option is they pay upfront, and they pay for every phone call and they pay for every statement. It's what your client base finds most convenient to them is what I'm getting down to.

KM: It's all about providing consumer choice. Personally when I see my planner I prefer to pay by commission, many of my friends prefer fee-for-service, it's simply a matter of choice.

The other hidden issue is that there has been a lot of discussion in the industry about smaller clients. The smaller



Corinna Dieters

amount consumer probably could not afford a financial plan [with an upfront fee] so unless there is some form of commission-based selling they probably cannot have their financial needs attended to by a planner, and that would be a great shame.

KH: If a consumer can afford to pay upfront then that should be their right to do so, and I could even understand if [the financial planner] were to give them a discount as a result of that.

On the other hand, if the consumer is making a smaller investment which isn't worth [the adviser's] while or they don't have the means to pay for the plan directly, then it should also be their prerogative whether they decide to pay for it upfront or rely on the commissions that flow through.

However, we do need a full and concise form of disclosure... We need to make sure the consumer understands exactly what is being disclosed to them. So having a general management expense ratio or universal figure like 2.6 per cent or 2.1 per cent, that really has never meant much for consumers who don't necessarily understand how we got that number.

Commissions are a way of life, they are a means of payment, and sometimes that's the best the consumer can afford, and they shouldn't be precluded from this service, which really is quite impor-

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tant for those people who seek to build up wealth or a level of social security.

RG: I just think it is simplistic just banning commissions and I know even the Labor Party has gone out suggesting to ban commissions, but it doesn't want to ban all commissions, it's happy for some group commissions to be paid, which is interesting.

But the question has got to be, if you are going to ban commissions, you ban any related party payments, so that means for example that people on salaries who are selling product, they shouldn't be receiving a salary, people who are BDMs who are working in funds or advertising products, they shouldn't receive a bonus or indeed a salary...

So I think it's too simplistic to just ban commissions. You would have to ban all payments for advice where there is a related party transaction. And that would in effect dismantle the



Mark Schroeder

whole service. And then just take it to the next step – if we do it for super, why don't we do it for household insurance, why don't we do it for travel insurance. You'd bring down the financial services system if you took that particular notion to its logical extremity ... I mean these are effective ways of distribution. And to remove them based on one particular so-called unfavourable practice, I think would be disastrous.

CD: I agree with both Khaldoun and Richard's comments. We don't believe that we need to move to a pure fee-for-service model because it doesn't necessarily overcome the issues that we're talking about. So I endorse both comments, and whilst we do have members who say that it would fix everything, we don't necessarily agree with that.

RG: A relative of mine had a small lump sum on retirement and I said to him, how did you pay for the advice you got? He said I paid for it through the trail commission. I said why didn't you pay an upfront fee? He said 'I wouldn't touch that with a barge pole, I don't want to spend \$1,000'. And what he got for that, if that advice is wrong, he would be straight down to FICS, for no cost, to screw that planner. And that's a pretty bulletproof way of getting advice. And yet he wouldn't have gone to that particular service provider if he had had to pay an upfront fee.

MM: Is it easy, from a business perspective, for financial planners who want to switch to a fee-for-service model?

KH: This is a really important topic, and I speak to a lot of advisers and they tell me in reality that they would rather have the trailing commission because the trailing commission adds value to their business, and also over the life of a product inevitably they will get more from a trail than they are like-

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Peter Bobbin

ly to ever get from an upfront fee.

As I understand, there are literally thousands of advisers who wake up every morning to \$500 or whatever they're receiving from the hundreds of products they have written over their lifetime. And this is a real problem in the way they are remunerated. I think commissions are important, but why should advisers receive a commission for the life of the policy?

MS: You can't provide...service on air. If a client wants to pay an upfront fee and get into a fund, and the manager works hard to consistently keep the fund performing and so forth and they only want to pay one fee for it, that's fine, and there may be a market for that.

But in reality, to ensure that the best investment advice is consistent, there's

got to be a balance between what a client wants to pay upfront and what they want to pay for ongoing service.

KM: You can have a very valuable business based on fee-for-service. When I've spoken to planners who are looking at the alternatives, and considering whether or not they should change to fee-for-service, the main thing is setting up business systems around charging on a time basis. You know lawyers will have everything so it records through the clients' files. If you make a photocopy you have to enter a client number, all your time is recorded on time sheets, and there's quite massive administrative systems around moving to fee-for-service.

So for planners, most of the challenges are establishing the systems, and

unlike lawyers, they're not used to the concept of fee-for-service.

PB: My experience is that the younger advisers embrace fee-for-service and the older advisers, it's not that they fear it, it's just that it's something new, it's a new concept, as Kate says, it's difficult for them to deal with. So, with some advisory groups, it's not until they have some young blood that pushes them to fee-for-service.

CD: Just on that, I think one of the things that does come directly from our life insurance side is this notion of valuing businesses based on recurring revenue, which really is a whole lot of nonsense. A business has to be valued as a business, not just on recurring revenue streams and we multiply it by one, two or three times.

So I think perceptions and understandings about what is valuable and what constitutes value are changing, and the comments that Kate made around having systems are really relevant comments.

People need to understand whatever business model they have, it's the business systems that are valuable.

MM: In the context of this discussion, if there was one thing you could change about the financial planning profession, what would it be?

KH: There isn't enough consumer confidence there for people to actually use



Freya Purnell

financial planners, and I think the industry needs to engender this confidence in consumers.

So what I would do if I was running the industry is embark on a consumer education campaign that engenders confidence and enables people to think their money is secure.

RG: On this occasion my comments are brief, and on this occasion my comments are unique, because I agree with Khaldoun. I think consumer confidence in financial planning is critically impor-

tant, and I think we, the FPA and the wealth management industry have to do a better job.

KM: I think as an industry we're very critical of ourselves. I don't think that is a bad thing because it leads to continuous improvement, but in terms of educating the consumers about our industry and the level of regulation, I think fund managers have a responsibility to get behind financial planners. I'd like to see more of that.

PB: FSR is a good start, but that's all it is. Compliance is so 'tick a box' generated now that there is the danger that the consumer will be left out of the whole picture.

That's not to undermine FSR, not to undermine what the FPA and IFSA have been doing and so forth, all that is a good start, but I think we've got to take the focus off the compliance 'tick a box' and perhaps move more into a consumer centric emphasis of advice.

MS: The legislation should assist us to do the best by the client, and a classic example of that is the Statement of Advice. It is just too confusing and puts people off. So if I could change all that from the regulatory view, then that would be what I would change.

CD: What I would like to see changed is a much more consultative approach by regulators through associations and consumer groups, actually setting the

way forward...We have a great opportunity now with a new set of regulations to actually create the future that we've been talking about.

What I would like to see is ASIC working with us to define what that means and consumer groups working with us to actually define what that means, rather than us to be responding to criticism and responding to policy papers that have no basis.

This is an edited transcript of the roundtable discussion.



Richard Gilbert