SUBMISSION TO THE PARLIAMENTARY JOINT COMMITTEE ON CORPORATE AND FINANCIAL SERVICES

INQUIRY INTO FINANCIAL PRODUCTS & SERVICES

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1 EXECUTIVE SUMMARY

There is a lot to recommend in the current financial advisory system; a fact that is often overlooked by consumer groups and other policy influencers. As with every system, however, there are opportunities to further improve particular aspects in order to better serve the interests of the majority of consumers. This submission has been based on over forty years combined experience within the financial services industry and, most importantly, consistent feedback from our advice clients.

1.1 Fees & Commissions

Clients expect to pay a fee for advice and related services. The word "commission" has become synonymous with the notion of "secret deal", but in this context it is best seen as a payment that is linked to the provision of a particular product and one that a client cannot stop without changing their investment. We believe that **service and advice must be independent** of the specific investment or product recommended. Based on our experiences in this market over many years and, most importantly, **based on feedback from our clients**, we would make the following key recommendations:

- We do **not** favour product based payments made directly to adviser groups by product providers.
- We do **not** support large up-front or contribution based commissions. Not just for investment products but particularly for insurance policies (where there is generally a significant imbalance between the initial and on-going commissions).
- Where a client has chosen to have an on-going advice relationship with a planner, we believe that advice fees based on **funds under management** (FUM) represent the **most equitable** arrangement for clients and advisers. We would argue that fees charged on this basis provide the best alignment of client and adviser interests, and remunerate adviser "proactivity" – which clients rate as a highly valued service.
- We support the full **tax deductibility of advice costs** for all consumers (ie individuals, superannuation funds, trusts, small businesses and companies) in the financial year in which they are rendered.

1.2 Sponsorship & Soft Dollar

We would argue that there is significant opportunity to curtail some of the practices that have historically been viewed as acceptable:

- We would support any moves to **restrict sponsorship of dealer groups** (or member firms) by product providers – it creates an expectation of "favour" particularly in the minds of the product providers.
- We do not believe that advisers should receive gifts or other procurements from providers that exceed the FPA's (currently) nominated limit of $300. In the absence of their prohibition (which we would support), we believe that an adviser's **soft dollar register** for the previous twelve months and "since inception" should be reproduced in the "Things you should know" section of every Statement of Advice that they provide.

1.3 Administration Platforms or Wrap Systems

Administration platforms (or Wraps) have much to recommend themselves, particularly when it comes to saving time for the adviser - the value proposition for most clients, however, is potentially not as clear-cut. Nonetheless, we are concerned about the lack of transparency that is continuing to develop in this space:

- We recommend that adviser groups be **prohibited from accepting rebates** from platform providers, accept in situations where the full amount of this rebate is passed back to the client (this includes white-labelled or adviser branded platform arrangements).
- **Volume-based rebates** paid by fund managers to platform providers need to be outlawed or refunded to clients in their entirety.
- The fee charging and profit sharing arrangements that exist between the big four banks and their product manufacturing arms (ie investment/wrap providers) need to be examined.

1.4 Anti Money Laundering & Counter Terrorism

With regard to the Committee's term of reference relating to the regulatory environment for products and services, we have noted a number of disturbing trends over the past twelve months or so that have accompanied the operationalisation of the AML/CTF Act 2006. These trends have had the specific

effect of reducing the level of competition in the marketplace and increasing costs to consumers. In particular we have noted:

- An exponential increase in the paperwork required to make **direct** investment applications on behalf of clients.
- Quasi "**third line forcing**" by integrated providers under the guise of AML (eg your client now has to hold our transaction facility "A" if they want to invest in product or service "B").

These practices simply layer more cost and discourage clients (and advisers) from moving investments between providers. We would urge that the post-implementation adviser and client consequences of the new legislation be reviewed.

2 Fees & Commissions

There has been a lot of talk from all sides of this debate about the relative merits or otherwise of differing advice remuneration structures. Not to put too fine a point on it, but everyone is entitled to their opinions and postulations; moreover they are welcome to quote the odd anecdote exampling reprehensible behaviour by a small minority. However, we would argue that if the Committee wants to understand what fee-structures work and what don't, then they should be talking to a cross section of consumers (from all walks of life) and they should also be talking to the adviser groups (or member firms) who are providing first rate advice and client servicing to the extent that they have been retaining/growing their client numbers and funds under management over time.

The other thing that is missing from this debate at present is some robust statistics so that the nature and apparent extent of any problem can be properly assessed. Our belief is that product-based commissions have significantly reduced over the past 2-3 years. We believe that only a minority of advisers now accept up-front and/or trail commissions from fund managers (product providers). However, it is **politically expedient** for a number of groups to have consumers believe otherwise.

Based on our experiences in this market over many years and, most importantly, based on **consistent feedback from our clients**, we would make the following key recommendations:

- We do **not** favour commissions paid directly to adviser groups by product providers (there are certain structured & risk products where an argument could be made for their continuance, but these would be the exception, rather than the rule). There needs to be a clear separation between the provision of "product" and the fee paid by a client to an adviser for advice and related servicing.

- We do **not** support large up-front or contribution based commissions. Not just for investment products but particularly for insurance. It seems quite unbelievable that an insurance provider can pay out 120% of a policy premium as a commission to a broker or adviser. Whilst level or flat commissions are offered as a remuneration option by all insurance providers, it would seem that for significant reform to occur in this part of the market, then level commission structure need to be legislated. Such a commissions structure does not provide any incentive to "twist" business and sets a logical timeline for annual review.

- Advice fees based on funds under management (independent of the specific investments held) represent the most equitable arrangement for clients and advisers. There has been a lot of talk about the virtues of the pure "fee for service" model, but **based on re-occurring feedback from our clients this simply leads to the perverse situation where clients are actually reluctant to talk to their adviser** for fear of incurring additional costs. We hear time and time again from our clients that they would rather not talk to their accountant because they "turn the meter on as soon as they pick up the phone or receive an email". This type of "fee for service" arrangement simply focuses the provider on maximising the amount of time spent on a client without any real regard to the quality of the final outcome. Further evidence of the failings of a fee-for-service system can be seen in the over-servicing that exists in the medical and legal professions.

No system is going to be perfect. However, FUM-based fees, directly negotiated between the client and the adviser on a basis that is independent of product selection (or asset class) are the most equitable alternative. Clients are more than happy to see their adviser with "skin in the game" - when client balances go up, then the fee they pay also rises. If their balances drop, then the fee that they pay also falls. This creates (quite rightfully) an expectation amongst clients that advisers will look to make recommendations that are in the best interests of clients, looking to preserve or grow their wealth over time.

The FUM fee acts as a retainer for advice services. Our clients know that if markets undergo some type of cyclical shift or if a product provider falters, we will be in contact with them to review their asset allocations or make recommendations about substituting an alternative manager. We don't wait for an annual review or some other chronologically prescribed restructure date. The FUM fee is the most appropriate way to remunerate **proactivity** and it is this proactivity that is paramount amongst our existing clients and the new clients that we have acquired (via referral) over the past 6 months.

Moreover, if clients wish to approach us about some aspect of their investment portfolio; if they have concerns or indeed if they think there are opportunities within the market or if they would like to refresh their financial projections or examine some further strategic opportunity, they know that they can discuss these things with us at any time without additional cost.

The other important aspect of a FUM-based fee is that it **can be terminated**, by either party, at short notice and without upsetting any of the underlying investment arrangements that might be in place. In this regard, we have had one or two clients who have elected to "suspend" their FUM-based fee and do without proactive

advice and servicing for a period of time (until (say) markets have stabilised or the proceeds from other maturing investments are available).

From a first principles perspective it is desirable to attempt to align the structure & nature of any remuneration model with the desired client outcomes. As with any system, if you take this philosophy to its logical extreme, you will end up with an extremely complex and unwieldy model. Our view is that FUM-based fees provide the best framework for incenting advisers to pursue the best outcomes for their clients.

Finally, we would note that we support the **full tax deductibility** of advice costs for all consumers (ie individuals, superannuation funds, trusts, small businesses and companies) in the financial year in which they are rendered. Given that there is a direct relationship between the incurrence of such fees and the subsequent generation of taxable income, we do not believe that such fees should be amortised/treated as part of the cost base of an investment. We believe that tax deductibility would also assist in accelerating the move away from product-based commissions.

3 Sponsorship & Soft Dollar

Axiom has serious concerns about the current Sponsorship and Soft Dollar disclosure arrangements. We believe that transparency on this issue is **no substitute** for the removal of any potential for conflict of interest.

In the first instance, we maintain that no Sponsorship or Soft Dollar benefit should ever be made available to a dealer group, Responsible Officer or Authorised Representative (we believe that the current FPA disclosure limit of $300 is an appropriate maximum to affix to sponsorship or soft dollar benefits). There is simply no need to accept sums over this amount, it is purely "payola". Removing such incentives will have a positive effect on the advice culture. If an "excluded person" wishes to attend an event that is being funded or arranged by a fund manager or product provider, and the value of the benefit is deemed to exceed the (say) $300 limit, then the Adviser Group in question can simply reimburse the provider for the dollar value of the benefit.

Secondly, if Soft Dollar benefits in excess of the $300 cap are not to be outlawed (which we believe they should) then there needs to be better disclosure of their nature and dollar value. In this regard, it would seem prudent to include the "previous twelve months" and "since inception" soft dollar benefits (in excess of $300) received by a particular adviser in all Statements of Advice prepared by that adviser. This will at least help consumers form a view about potentially "tainted or biased" advice at the time it is provided.

We acknowledge that some Planning Groups and/or advisers will feel uncomfortable with this recommendation, but we would add there is **no compulsion** (nor should there be) to accept a gift.

4 Administration Platforms or Wrap Systems

Axiom Wealth is increasingly concerned about emerging trends in the Administration System, or Wrap, space. Recent developments seem to be counter to the desire to increase transparency and are having the effect of further entrenching the positions of the incumbent players.

4.1 Fund manager Rebates

Much of the current debate seems to be focused on situations where an adviser might accept a commission or rebate. But what is largely overlooked and is potentially much more insidious is the growing and undisclosed practice of rebate payments being made to providers based on an inflated Management Expense Ratio (**MER**) by a Fund Manager. Many Fund Managers create multiple classes of an identical product or fund (simply variations on a theme) all with different fee structures - this is done solely as an offset to payments that must be made to platform or wrap providers.

4.2 Volume-based rebates

The volume based rebate exists exclusively for the benefit of large dealer groups. The more FUM a dealer group or individual adviser directs to a particular platform, the more they in turn get paid in rebates. It has the effect of taxing clients (disproportionately from non-aligned dealer groups), with the resultant spoils being used to support the inefficiencies of larger dealer groups. Axiom does not deny any dealer group a right to exist, but we would expect that clients be made fully aware of all fees that are being charged and who ultimately is the beneficiary of them.

Axiom recently had an enlightening experience with a leading Wrap provider, when we asked for a white-label wrap ("Axiom Wrap") to be created. Our key criterion was for all Fund Manager and Volume Rebates to be **returned directly to clients**. Our request was met with a response to the affect that "*there is no way we would create such a product, as we would be undermining the position of every other dealer group we interact with*". Interestingly, we were only seeking to do the right thing by our clients and needless to say we do not have an "Axiom Wrap" nor do we much use of wrap accounts.

4.3 Restrictive Trade Practices

All too often we see examples of large institutions mandating that their advisers use one particular administrative or wrap platform. This leads to situations where wraps are used when they are not appropriate for the client's needs or where a different wrap (provided by another institution) might be more cost effective for the client's circumstances. The other disturbing trend is that these proprietary wraps often have higher fee scales applicable to them, purportedly to defray the higher costs in these larger institutions – so much for economies of scale.

By way of example we highlight a leading Financial Services provider. If a client invests (say) $3m into a Wrap through a Big 4 Bank adviser the fee would be $6,800 for the use of the administration system. However, if the client invested $3m into exactly the same platform through a non bank adviser (using the independent financial adviser version of the same wrap) then a fee of $4,465 would be levied. Given that the bank in question owns the wrap provider, the $2,335 difference is simply an additional client fee – organisationally it is transfer of profit from the product manufacturing arm that masks the inefficiency of the distribution business.

We believe that the fee and transfer charging arrangements that exist between large product manufacturers and large distribution businesses (typified by arrangements between the big 4 banks and their investment subsidiaries) need to be reviewed.

5 Anti Money Laundering & Counter Terrorism

With regard to the Committee's term of reference relating to the regulatory environment for products and services, we have noted a number of disturbing trends since the introduction of AML&CTF legislation in December 2006 which have the specific effect of reducing the level of competition in the marketplace and increasing costs to consumers:

In short we have seen:

- An exponential increase in the paperwork required to make **direct** investment applications on behalf of clients (all intimated by the product providers in question to be as a direct result of AML)
- The persistent requirement to re-identify the same client making multiple investments. It doesn't matter that the client has been previously identified by another provider, the same level of paperwork and certification must be repeated.
- Quasi "third line forcing" under the guise of AML (eg your client now has to hold our transaction banking facility if they want to hold an investment with our institution – again, justified by the organisation in question on the basis of the introduction of AML)

These practices simply layer more cost and discourage clients (and advisers) from moving investments between providers. The other thing that they encourage advisers to do is to place client investments inside wrap or administrative platforms (with the attendant issues outlined in Section 4), where the identification impost for the adviser is relieved – however, the client is forced to pay additional wrap fees.

We would observe that every investment that a consumer (or other entity) makes now requires the quoting of a tax file number (whereas previously disclosure was voluntary). A simple solution would seem to involve the linking of the TFN to the once-only identification of a client for AML investment purposes. Appreciating the sensitivity around such a scheme, involvement from a consumer/business perspective could be voluntary (advisers would certainly encourage clients to participate in such a scheme).