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Intelligent advice with Integrity

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**Federal Government response to Ripoll enquiry.**

Dolfinwise is a small financial services business in Spring Hill that operates on a pure fee for service basis (we avoid commissions). We operate in the manner that the government's intended legislative changes ostensibly wish to encourage. We work solely for our clients in a clear and transparent manner, deliberately avoiding conflicts of interest and focusing on providing advice rather than products.

Our understanding of the Government's proposed changes is that the Government wishes to reduce (or remove) conflicts of interest in financial services that leads to poor product advice to clients. They also wish to reduce the cost of financial products (and superannuation) to consumers particularly in the retail sector.

We are passionate advocates of the intent behind the changes the Government is seeking to make, attempting to ensure consumers can get quality advice. However, we are convinced that the changes proposed alone will not achieve the stated aim but rather increase the market share of product providers who control financial advice networks and have significant adverse consequence on the ability for consumers to get good financial outcomes.

**Summary of concerns.**

Under the proposed legislation **volume rebates** will be banned. We are in support of this move in principle, however we believe the majority of product providers who have vertically integrated distribution will continue to pay these amounts of money to their "in house" advice groups under other guises (such as "marketing allowances" or "licensee subsidies"). As a result the impact will be on the more independent advice groups who don't recommend their own products. Clearly this is counterproductive to trying to increase the impartiality of advice. The outcome will be that the larger more independent groups will in one form or another obtain their own products (as PIS and Count have declared in the media) to replace their margins and hence increase conflicts of interest

FPA FINANCIAL PLANNING ASSOCIATION OF AUSTRALIA PRINCIPAL MEMBER

in the industry) or ultimately be bought by one of the four banks. This will reduce competition and reduce ability for consumers to get genuine advice.

The intent to make clients sign a piece of paper each year **(the opt in reform)** in order to keep paying their advisers to avoid "passive" income and ensure client's get value for money is another idea we approve of in principle. However, again our fear is that the large institutions (product providers) will move their advisers to employees and argue that there is no recurring commission to their advisers; and that there is solely product revenue. They will then invent other means to reward advisers based on their performance. So by inflating product fees (or not allowing fair and even competition to drive them down) their fundamental business of selling products (masquerading as impartial financial advisers) will not change. The small number of "independent" advisers without conflicts of interest (and their clients) will be disadvantaged in an uneven playing field not being able to subsidise their advice from inflated product margins.

In summary we applaud the intentions of the law changes but urge that the government analyses carefully the unintended consequences of their stated policy intentions. I am convinced the outcomes will make problems of biased advice worse rather than better. Ultimately this will not help downward pressure on product costs through destruction of the independent adviser market.

**Solutions**

While product providers control 80% of financial advisers by owning their financial service licensees no amount of regulation will solve the issues of biased financial advice. Licensees not named after their parent company should be required to clearly identify who the parent company is upfront with clients and point out that this mean they have an inherent bias towards, and interest in using that particular companies products. Currently too many clients believe they are getting impartial advice when they are not.

Clients also in our experience want advice more often than products. If planners get paid via a product (whether it's called an asset based fee, trailing commission or any other name) then the planner is not providing unbiased advice but is trying to include a product that will create remuneration payable to them in their advice. They are therefore biased against term deposits, paying down client's debt and using products such as industry funds that pay no remuneration. Clients need to be made aware of this.

Taking a stick approach to the financial services industry increases costs to consumers. FSRA (the Financial Services Reform Act) in our view approximately doubled the cost of quality advice to a consumer. The more regulation, red tape and paperwork required the more expensive advice becomes and the more out of reach of ordinary people. The accounting and legal industries have provided complex advice to clients for centuries without the need for all the current red tape the financial services act has imposed on consumers. It hasn't been deemed necessary in these other industries because generally these professionals act for their clients and are paid solely by their clients. Excessive and expensive compliance regimes have not been deemed necessary to ensure appropriate behaviour.

The right outcomes in financial services will occur more often by providing incentives for financial advice firms to set up their businesses and remuneration systems in the right manner. Bank and industry fund aligned advisers will always have their place as some people only want or need product advice but consumers should have access to holistic impartial advice at a reasonable price if that is what they seek without being conned by product sales people. Creating incentive for firms that provide genuine advice and act without conflicts of interest is the only long term solution to this issue.

**Definition of independence**

The current standards to claim independence as a financial adviser are so onerous as to make it virtually impossible to meet. One cent of commission received from an inherited life insurance policy that cannot be turned off disqualifies an adviser from claiming independence.

We believe the government should change the definition of independence so all advisers who meet the following criteria can claim and market themselves as independent:

> -No product provider has any interest in either the financial services licensee or advisory business.
> -The the financial services licensee or advisory business has no interest in any products that they recommend to their clients.
> -No more than 20% of the financial adviser's remuneration (including soft dollar) via their licensee comes from one source (read product group).

This last point ensures that adviser who charge their client's directly will meet definition of independence as long as they are not retaining significant volume bonus or product payments (trail commissions, asset based fees etc) from one provider. Commission based advisers (read those who charge as a % of assets) who receive more than 20% from one IDPS platform will be excluded.

Creating a new genuine class of independent adviser and incentivising this class of adviser to work for their clients solely will encourage more in the industry to clean up their conflicts of interest in order to be able to claim independence. This will give consumers real choice and make it easier for those looking for genuine impartial advice (as opposed to investment recommendations) as to where they can find it.

By encouraging the independent adviser market to grow, it will mean the product providers will be forced to compete on their products' merits alone (rather than through more nefarious means like volume bonuses) for a share of that independent market. This will ultimately encourage both product innovation and pricing competition as opposed to creating a 4 bank oligopoly like the petrol cartels.

If independent advisers start to operate without product bias' then many of the compliance requirements under FSRA would become unnecessary and red tape could be removed. This would drive down the cost of quality advice making it more accessible to average people.

Incentives given to advisers who operate in accordance with new requirements could be a reduction in the compliance burden and even tax deductibility of their fees. Ultimately this would result in wealthier consumers, higher government tax revenue and lower social security outlay.

We are passionate advocates of financial advice free from conflicts of interest being accessible to for all Australians. While we philosophically support the changes proposed we strongly believe that implemented alone they will damage the independent advice market and further entrench product sales as the driver of consumer advice rather than client outcomes. The fundamental issue needing addressing in the financial service industry is ownership of advice by product producers and the conflict of interest this causes. The best solution is to facilitate and promote the growth of a robust and professional independent advice sector alongside an improvement of genuine disclosure of conflicts of interest amongst vertically aligned groups.

**Intra-fund advice**

The financial landscape is exceedingly complex yet it is a critical area of all our lives. As a result good advice is always going to be required to get the best outcomes. Unfortunately due to the complexity of the financial world we believe limited advice when given without full knowledge of a client's circumstances can be highly risky. As one of the few financial advice firms that does interact with and recommend on occasion industry funds to our clients we also wish to provide some insights to the government based on our experiences with intra-fund advice.

We have numerous cases where our clients have been offered some intra-fund advice over the phone from their industry funds. Following the "helpful" guidance given would have on numerous occasions caused disadvantage to our clients. The reason being that a person's whole financial situation is interwoven and good advice cannot be limited to simply what is happening in one fund they may hold. In one case, a recommendation to make a $1000 personal contribution (to take advantage of the government co-contribution) would have if followed caused the client to pay $70,000 in penalty taxes for breaching the contributions cap. There are numerous examples we could give where limited advice is dangerous. As a result we strongly urge the government not to increase the scope of intra fund advice without first ensuring the advice is given by advisers who have taken the time to understand the client's entire circumstances.

This letter represents the express views of Jason Bragger and Dolfinwise and is not endorsed by any other party.

Yours faithfully

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