

SUBMISSION to the Financial System Inquiry

Future of the Australian Financial System

23rd August 2014

I am a Certified Financial Planner in Melbourne with over 15 years' experience in financial planning. I speak a great deal on financial literacy education and the way in which consumers can access good advice. I also adjudicate on the Financial Ombudsman Service, Investments, Life Insurance and Superannuation Panel as an Industry Representative.

My observations over the years have lead me to the conclusion that the key problem in the financial services industry lies with the structure of an industry that claims to be offering professional and independent advice in the best interests of the client, but is (for the most part) culturally driven by conflicted remuneration and the imperative to sell products. This statement is not a reflection on the personal morals or ethics of individual advisers in the industry, but on the structure of it, within which those individuals are required to work.

I do not believe the recent FOFA legislation, regardless of the final structure, will make any difference to the culture and behaviour of the financial planning industry. I believe that FOFA, whilst well-intentioned, is full of political compromises and complexities which have the unfortunate result of allowing those who do not wish to comply with the spirit of the law to not do so. For example, certain commissions paid on investment products by third parties have been banned by FOFA; however, commissions paid on investment products by clients (also known as "asset or percentage base fees", and misleadingly called "fees for service") have not been banned (except on gearing).

As a result, for investment advice, the industry is moving to commissions paid by clients. This is hardly a surprising result. Such payments to financial planners are fundamentally conflicted, a point that becomes obvious when clients seek advice on, for example, whether they should pay down a mortgage, invest in cash, nominate to receive a government-guaranteed indexed pension or salary sacrifice into a company nominated superannuation fund. In all of these common circumstances, it is not commercially viable to charge asset fees, so that clients will often be dissuaded from sensible financial decisions in order that products can be sold on which asset fees can be charged (typically, managed products issued by financial institutions).

Sadly, the industry continues to successfully promote the view that, as a result of FOFA, and other good governance practices, its participants are moving to professional "fees for service". Therefore,

"Helping people make smart choices about their money"

it is claimed, the industry is becoming un-conflicted and trustworthy, when, in fact, all that is happening in most cases is that clients (rather than third parties) are paying the commissions.

It is disingenuous to suggest (as many in the industry do) that all will be resolved now that there is a “best interests test” in the law, that (some) conflicted payments have been banned and that disclosure requirements have been tightened. The practical reality is quite different. When faced with managing a conflict between a client’s long term best interests and an immediate need to satisfy a product sales target (thereby earning a conflicted payment for so doing), the client’s best interests are potentially jeopardised. This is a completely understandable (and intended) outcome.

Therefore, until we are willing to ban all conflicted payments and incentives, not just some of them, little will change and the behaviour and current culture will remain. The industry knows that, but it is unwilling to act because most of it is structured as a vertically integrated product distribution network that has no real interest in structural and cultural reform that may jeopardise the flow of products sales.

To establish a professional and independent advice industry that is structured so the best interest of clients is served a number of key aspects **MUST** be implemented;

Individual licensing regime

To act as a financial planner each adviser should be individually licenced and individually responsible for the advice they provide. This would remove product manufacturers from using the advice process as part of the distribution channel.

Institutions including banks, insurance companies and industry funds have a financial planning arm as an important strategy of their business operations. In my opinion their primary goal is to simply sell their product and thus enhance their profit.

Ban product manufacturers and suppliers from holding ownership in advice businesses.

A business owned by an institution that sells products creates an immediate and obvious conflict of interest.

Many “boutique” advice businesses have ownership partners, including institutions. Again, the objective is to sell more products.

Ban advice businesses from receiving any form of commission

To be independent and act only for the client the adviser must not be able to accept *ANY* commission (regardless if paid by a client or product issuer) or volume arrangements.

This means No Commission – including insurance commissions. Any receipt of commission immediately creates a potential conflict of interest.

‘Advisors’ who are remunerated through commission based payments need to be clearly identified as Product or Sales Agents and not be allowed to use the term ‘Financial Planner’.

A ban is also needed on any arrangements advisers may have in place with product suppliers. These include grandfathered volume arrangements and trail commission payments as well as other benefits such as software, office support and other services.

Ban percentage based fee structures

Percentage based fees can simply be a commission by another name.

This creates an immediate conflict in that the more of your funds that go into a particular pot the more the adviser gets paid. The services probably haven't changed, the complexity of the strategy probably hasn't changed, yet the adviser gets paid more.

If we are not willing to make these changes, and we continue to engage in "workarounds" (based on compliance based box-ticking and politically compromised regulations to appease vested interests), then we are consigned to no real change in the industry's culture and conflict-driven behaviour.

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