PLAYFAIR | TAN

26 August, 2014

Financial System Inquiry
Second Round Submissions
By Email

Dear Panel,

The Responsibility of Money

We enclose our submission to the current round of the Financial System Inquiry ("FSI").

PlayfairTan is a boutique investment advisory firm, providing advice to wealthy individuals and families. We operate under our own Australian Financial Services Licence ("AFSL") and have accumulated years of experience in large financial services organisations.

As participants, we continue to be dismayed by the lack of true professionalism in the industry.

There are multiple factors that contribute to this and many are highlighted in the FSI Interim Report ("Interim Report"). They include:

- lack of structural integrity in financial services organisations;
- lack of standardised training or registration requirements;
- lack of a single statutory/membership organisation with standard-setting powers; and
- lack of competition in the industry – as the Interim Report notes, there are only 15% of firms which are independently owned.

Often, institution-owned firms are focused on "distribution" dressed up as advice. A phrase such as "share of wallet" is a commonly used term that exposes in three simple words the primary modus operandi of some organisations.

Our submission is based on our engagement with clients, past experience as employees, and now proprietors of a unique financial advisory firm. Our primary focus is the wealth management and financial advice sections of the FSI (sections 2 and 6).

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We applaud the FSI's focus on efficiency, stability and fairness of the system. In drafting our response, we found ourselves repeatedly drawn to three "R" words: responsibility, respect and reciprocity. They can be applied across different stakeholders from legislators to consumers of financial services (and everyone in between). These simple principles can help frame any of the issues to give greater clarity in deciding the way forward.

Section 2: Competition – wealth management (pg 2-37)

The Inquiry welcomes stakeholder views on competition issues in the broader wealth management sector.

As the Inquiry has noted, there is no clear definition of wealth management. The range of services that wealth management can encapsulate include: funds management, superannuation, insurance, stockbroking and financial planning. In addition, there are also a range of ancillary services that may include debt management, estate or intergenerational and philanthropy advice. Often, the motivator for many firms is to grow their assets under advice. Firms seek to outdo each other by amassing an ever bigger footprint. The only existential reason is to become bigger and more profitable. One way of achieving this is to secure more channels of distribution. As a business proposition, this is not necessarily unreasonable. However, our view is that the wealth management industry must have a higher standard than most: ultimately, we are dealing with someone else's money. The outcome and impact of the industry's conduct has an immediate or otherwise long term repercussion for its end customers, typically a private individual or family group. It is our collective duty to discharge our obligations ethically and responsibly.

There are three main routes to achieving the type of growth that the industry is accustomed to: organically, by acquisition or by increasing their [sources] of margins. The first is difficult to achieve, it requires focus, dedication, tenacity and patience. In a world where short-termism dominates corporate thinking, organic growth is simply not enough. Acquisitions and the ever more vertically integrated organisations are two ways to generate more revenue and margins by wealth management firms.

A concentration of players in any industry is not healthy. It can breed complacency, reduce the quality of outcome and increase cost for consumers. There is a need to ensure a healthy level of competition in the wealth management industry to ensure the best possible consumer outcome. The industry has focused on delivering *quantitative* outcomes for *itself* for too long when the core focus should be the delivery of *quality* outcomes for its customers. The only yardstick in this frame of competition is the reference to assets or funds under advice, easily observed amongst the major players.

A vertically integrated organisation has the ability to disguise the quality of its output. It is not possible to align internal sales target strategies that are maintained for the sole benefit of the house, such as revenue share, transfer pricing, hidden intra-organisation commissions or other forms of quantitative scorecard, to concurrently produce the best customer outcome. The murkiness and potential lack of transparency can only turn competition into a race to the bottom and not outcomes with a focus on quality. It breeds a sales driven culture and not an advice driven culture. We believe the Inquiry must address the systemic weakness inherent in these vertically integrated structures and contemplate the reorganisation or breaking up of these structures.

The wealth management industry must learn to respect its role as adviser, facilitator and custodian of someone-else's money. Clients are therefore not simply economic units, regulatory and compliance requirements are not just checklists.

We believe that the industry is at an inflexion point where competition must return. Smaller players like PlayfairTan will emerge in different parts of the wealth management client value chain. We are more focused, more customer-oriented, smarter and better at what we do. We will lead the industry and we welcome healthy competition. To ensure a level playing field, competition must be maintained through various policy areas, including strong regulatory oversight, encouraging new players from related industries or foreign players into the market, incentives for small players to start up, reducing red tape and cost for wealth management businesses.

Section 6: Consumer outcome

Financial advice (pg 3-63 to 3-73)

The provision of financial advice imposes an obligation on the advice giver to take due care and act in the best interests of the advice recipient. Our obligation as advisers should always be for our clients first - this should be the case even without regulatory oversight. A person who is part of the distribution / sales force of the same organisation that originates or designs the end financial product is not an advice giver but a product sales person or an information provider. This is a simple definition. The distinction needs to be clear and does not need to be controversial: when a customer walks into life company A or bank B, the customer expects to be served product A from life company A or product B from bank B. It should be made clear that the service provided is a product service and not advice. Removing the word “advice” from the wording of “general advice” will go a long way in clarifying what actually constitutes advice. It will also serve to highlight the weight of responsibility associated with advice.

The word “advice” connotes a level of personalisation and tailoring to a person’s circumstances. It also implies a degree of independence and impartiality: when one seeks advice from another person, it is rare for that person to want to rely on another person’s *biased* advice. Independence both from a structural and advice givers perspective should be built into the equation when advice is sought, irrespective of the advice giver’s position. It must therefore follow that independence in advice must not only be reinforced, it must also be clearly delineated. Non independent advice (if there is such a thing) should be separately defined. As we have noted previously, vertically integrated organisations simply cannot produce an advice culture that aligns their corporate objectives with customer needs. The only way forward is a separation of advice culture away from a sales culture embedded in vertically integrated organisations, and a removal of any hidden, internal incentives to promote sales.

As the Inquiry has already indicated, quality of advice varies. This will always be the case but it is possible to improve the overall standard of the industry. The starting position must be the introduction of a higher education standard beyond the minimum. A university degree does not make a person more competent or ethical but it does demonstrate a base level of competency and capacity. Similar to other professions like accounting, law or medicine, a degree is one way of demonstrating a person’s aptitude. This is highly relevant in the understanding of our ever changing financial, investment and legislative environment. The Inquiry may also wish to consider post tertiary requirements, similar to the professional year in chartered accountancy or College of Law in NSW. An academic qualification is far from ensuring the provision of good advice but we believe it brings it closer. We would welcome forms of national exams, specific training and centralised registers.

To achieve a high level of standard, advice must be separated from product distribution. A centralised professional standards board in advice, tasked with standard setting, registration and enforcement, will ensure oversight and confidence of the financial advice industry as a profession. Similar to the Law Society, this body may be tasked with both representative and regulatory roles. It will also have a role in highlighting ethical issues faced by the industry. Whilst there are many representative bodies in the wealth management industry, it lacks a peak financial advisory body that can define and lead the industry with little influence from vested interests.

We do not believe that adding the phrase “restricted” to aligned groups would improve the outcome of financial advice without the broader structural changes. The more logical approach is for all advice to be independent, together with the other changes suggested in our submission.

There are costs associated with the provision of advice regardless of whether it is provided face to face, by phone or online. There also appears to be a general view that advice is good for consumers, yet consumers are not prepared to pay for it. This should not the reason to impede the necessary structural reforms that the industry needs. Like other industries, the wealth management industry should be allowed to innovate, adapt, compete and educate clients in order to overcome this perspective. What regulation can do is to provide the necessary framework to ensure transparency, accountability and independence of the industry.

Other Issues

Section 3: Funding

Impact investment and social impact bonds (pg 2-75)

We welcome any clarification that may be provided to superannuation and philanthropic trustees on impact investments.

Section 4: Superannuation

Direct leverage in superannuation (pg 2-117)

We believe that "the evidence that suggests borrowing in superannuation is often associated with poor financial advice" presents two separate and distinct issues. The first issue relates to leverage in superannuation, the second being poor financial advice. The second issue is addressed separately in the following section.

We are supporters of providing individuals with choices and the ability to take charge of their retirement savings, whether through a public offer or self managed superannuation fund.

However, we also agree with the Inquiry's view that "leverage should not be a core focus of SMSFs… and is inconsistent with Australia's retirement income policy"… that "the general prohibition of direct leverage on superannuation should be restored on a prospective basis". In addition, we suggest that existing leverage positions must be unwound within a reasonable window.

A commonly used but flawed argument in support of leverage in superannuation is that it is the trustee/members money and therefore they can invest in how they see fit. We believe for the following reasons, they should not be allowed:

- Integrity of the retirement system: As the Inquiry rightly points out, leverage can potentially introduce systemic vulnerabilities.
- Object of superannuation: The broad object is to provide a stable platform to assist with funding of a members retirement. Leverage introduces a different level of risk that we believe is unnecessary.
- Reciprocity: Superannuation is already a concessionally taxed environment. There are ample opportunities for leveraged to apply elsewhere other than this important nest egg. In return for these tax concessions trustees/members should expected to follow a set of rules and guidelines.

Self managed superannuation funds (pg 2-126)

We believe that providing individuals with choices in the management of their retirement funds will empower and benefit them in the long term. The growth of self managed superannuation funds is a net positive for Australia.

Prospective trustees/members have the obligation to consider for themselves the suitability of using a self managed superannuation fund. The issues may include the cost of operation, trustee obligations, investment strategy and members' profile. A reasonable expectation is that a person in this position will seek financial advice from a qualified person as part of their decision process and this decision ultimately rests with the individual. As individual circumstances are different, it is neither possible nor reasonable to regulate the establishment of self managed superannuation funds. Whilst advice can be encouraged, it cannot be imposed.

It is a privilege of the finance industry to be involved in advising and dealing with other people's money. That privilege comes with significant responsibilities that must be discharged honestly and with integrity.

Please do not hesitate to contact us if you wish to discuss any of the matters raised in our submission.

Yours faithfully

PlayfairTan