

OCTOBER - NOVEMBER 2009

professional

STANDARDS, EDUCATION AND PRACTICE PROFIT FOR FEE-BASED ADVISERS

PLANNER

Putting clients on track

THE THINKING BEHIND
SUNSUPER'S NEW SERVICE

.....

Investor Psychology

WHY SMART PEOPLE
DO DUMB THINGS

BIG BANG

ARE WE WITNESSING
THE BEGINNING OF THE END,
OR THE END OF THE BEGINNING?

When *The Australian Financial Review* finally reported in August what many in the financial planning industry had seen coming for years - namely that the Australian Securities and Investments Commission (ASIC) was recommending the banning of all commission-based remuneration for financial planners - you could almost hear the cacophony of collective reaction from across the industry.

Robust and hearty agreement was punctuated by aggrieved invective and quivering lower lips, while anxious water-cooler conversations buzzed across the nation. There were sighs of relief and guarded optimism as well as the obligatory weeping and gnashing of teeth. In good Shakespearean tradition, the whole gamut of emotions was enthusiastically expressed.

And with good reason. The changes being proposed by the regulator will be the biggest and most far-reaching the industry has seen since the introduction of compulsory superannuation almost 20 years ago. And as human beings generally have a love-hate relationship with change of any kind, regarding it with wary caution at best and downright fear at worst, the stage has been well and truly set for some rigorous soul-searching.

This in itself probably isn't a bad thing. In fact, there seems to be an emerging agreement within the industry so far that open and honest debate around the issue is a positive and much needed thing. And this long-overdue collective hitting of the "refresh" button has already put some of the industry's most deeply-rooted traditions and cherished creeds - many of which have remained previously unquestioned - firmly up for grabs.

Principally among these is the very question of what a commission is, the appropriateness of financial advisers charging them at all, and what effect this has had on the public's perception of the financial planning industry as a whole.

Jim Stackpool, managing director of Sydney-based consultancy firm Strategic Consulting and Training, believes the industry's reliance on commissions has helped to encourage a culture of laziness and greed, where the selling of products has become more important than the giving of advice, regardless of what might be in the best interests of the client.

"I think that commissions have generated the fairly anti-advice environment we've got at the moment because commissions are a lazy way of collecting money," he says. "I think we've lost a lot of the soft skills in our industry because we've been able to rely upon this silent, sometimes deadly commission component."

Joe Grogan, general manager of MCA Financial Planners in Victoria, agrees, describing the commission payment as an easy collection model with some hidden traps, most notably leaving the adviser as a "soft target" whenever something goes wrong.

"The payment is charged because there's a painless extraction method," he explains. "But the adviser becomes the weakest person in the chain and if something goes wrong, they're the one targeted because they received commissions. But if you're on a fee basis, I believe you'll be less of a target if someone else has caused an issue."

The charging of commissions, often in an underhanded manner and without clear, upfront communication with the client, has been a key component, but by no means the only one, in creating the larger problem now dogging the industry - that of its tarnished public image. While undoubtedly there are many financial advisers who work hard and operate at a professional standard, it's the less professional element that lowers the standing of the entire industry. Unfair maybe, but not unusual. It's a quirk of human nature that any group is usually judged as a whole by its least worthy representatives. Certainly in some quarters, financial planners are widely viewed in much the same way as used car salesmen were in the '70s and '80s.

"Financial planners are now generally categorised as untrustworthy and only motivated by self-interest," says Claudia Pritchitt, principal of specialist financial services public relations firm Pritchitt Partners.

"Indeed, the same perceptions apply to most participants in the financial services industry - planners, managers, product developers, and researchers alike - and are not helped by the recent company and fund collapses. Stories about excess, greed and incompetence have also contributed to the loss of confidence in financial services by the community at large."

Stories such as the former Storm financial planner who, as recently as August this year, had been

working as an authorised representative of another financial planning group, providing advice to shell-shocked clients regarding the tattered remains of their Storm investments, while charging commissions of up to 6.6 per cent for her advice.

After *The Sydney Morning Herald* reported this on August 31, the planner's authority to practise was hastily withdrawn, but there can be little doubt that the *Herald* ran the story in the first place knowing the fertile ground for outrage and disgust amongst the public, particularly other wounded Storm clients. It seems that in the wake of the global financial crisis, the public has been looking for someone to bear the brunt of the fallout, and the financial planning industry has, to a certain extent, become the sacrificial lamb on the altar of justice.

"The media's doing a brilliant job of putting it right down the bottom of the pecking order for status and respectability," says Stackpool.

While it's almost certainly true that the media has brazenly encouraged the public's jaundiced perception of the industry, the job of presenting financial planners as necessary scapegoats appears to have been relatively easy, due to the element of self-interest, greed and incompetence referred to by Pritchitt that has been an entrenched part of the industry for many years. Arguably, it's the glaring potential for the conflict of interest that exists with commission-based remuneration that has attracted that element of self-interest, greed and incompetence to the profession in the first place.

This in itself begs another important question: How was it possible for this unruly, some might even say sleazy, element to find its way into the industry in the first place? In answer to this, many industry participants now agree that entry-level requirements are too low, and that even some of the terminology, including the very definition of "financial planner" itself, needs to be re-examined, especially in relation to how it's policed and regulated.

Richard Klipin, chief executive officer of the Association of Financial Advisers (AFA), agrees that vagueness and ambiguity surrounding the actual term "financial planner" have been part of the problem and would therefore like to see the bar lifted on adviser education.

"The pathway to professionalism is experience

and higher education,” he says. “At the moment it’s too loose a term, and people who are not licensed can happily use the term financial adviser when they are not. While the minimum barrier of entry, which is a Diploma of Financial Services, obviously has a degree of rigour to it, I think across the industry there’s a fairly wide acceptance that the baseline level of education now needs to rise - and that’s about improving standards and improving confidence.”

Andrew Moylan, a consultant with the Sydney-based Encore Group, also believes the financial planning industry’s dearth of substantial entry requirements is partially responsible for its current public image problem and perceived culture of product peddling over advice giving. He refers to the analogy made in the seminal 1999 book *The Seven Stages of Money Maturity*, by George Kinder, founder of America’s Kinder Institute of Life Planning, where Kinder compares the financial planning industry of today with the medical profession of the late 1800s.

“The medical profession wasn’t a profession, they were the pushers of elixirs,” Moylan explains.

“So what you had was these medicine men pushing these elixirs and there was a lack of distinction between the medicine and the prescribing of it. The skill was in the diagnosis, but they made their money from actually recommending an elixir. I think it’s an absolutely perfect analogy for where we are as an industry. We’ve actually got the peddlers of product being paid by the product producers. And it’s interesting for me that doctors weren’t well regarded when they were peddlers.”

Stackpool agrees, citing the burgeoning computer industry three decades ago as another similar parallel. “The computer firms in the ’70s and ’80s said they were all about solutions, but they weren’t. They were just about moving boxes and products,” he says.

Accordingly, there’s already a widespread belief throughout the industry that the banning of all commission-based remuneration will principally affect how planners and advisers engage with their clients, encouraging a more upfront and advice-oriented relationship. This frontline position is surely the best and most appropriate place to begin that much-needed repair work to the industry’s reputation.

“I think the way we engage with our clients is going to fundamentally change,” says Stackpool.

“I don’t think clients are going to put up with the old ‘this is my product and look what it can do’ line any more. And I think that’s going to change the way we both engage with and service our clients and the way advisers approach the market. There’s a whole set of clients out there who simply don’t want advice, who never wanted advice. But they’ve been told they’ve bought advice when they’ve really bought a product.”

Stackpool believes that there’s always going to be a small proportion of clients with no financial complexity in their lives who understand how to reach their long-term goals and who require product, rather than advice, to attain those goals. But those people are the minority.

“Most people are either too busy or lack the skills, education, talent or time to do it themselves, so they’re going to rely on someone to give them advice as to what they need to do,” he says. “So the adviser of the future will still be providing a product but they’ll be providing it in such a way that it’s encapsulated with any advice.”

MCA’s Grogan believes that most planners are versatile and will adapt to the changes, but concedes that at the same time “they’re going to have to become much more upfront with their clients. And as well as that, they’re going to have to have a better value proposition. They’ll have to know what they’re doing for their clients, succinctly present their value propositions, what they do, and then just clearly enunciate how they get paid for it.”

Some industry participants also believe that with so much attention and discussion now focused on price, there’s a danger that the idea of actual value for money will be overlooked. As pointed out by Darren Steinhardt, managing director of Infocus Money Management, an independent dealer group based in Queensland, “It’s not on the amount you charge, it’s all on value. It should be irrelevant if you’re paying \$500 a year for your fee or \$50,000 for your fee, if there’s value for money, that’s what it’s all about.”

The AFA’s Klipin echoes this sentiment. “We’ve thought many times that the issue around compensation, when you focus on price and you don’t focus on value in price, then the whole discussion becomes fairly distorted,” he says.

The AFA is also concerned that the recommended changes to remuneration, while addressing an existing issue regarding conflicts of interest for advisers, may simultaneously create new issues, albeit inadvertently. Klipin says that “what’s heartening to see is that Treasury has come out with their submission and they’ve suggested that with potential changes of remuneration, on the one hand you may remove conflicts, and let’s understand that compensation and remuneration is all about managing and disclosing conflicts, but on the other hand you may actually cause a whole range of other consequences like barriers to entry for people who may not be able to afford upfront fees”.

In fact, the possibility of some middle- and lower-income sections of the community being effectively priced out of the market appears to be emerging as one of the more significant arguments against the banning of commissions. It is widely regarded as a very real possibility that service fees will rise in a post-commission world, and that these increases will have greatest impact on less well-off clients, the very people most in need of good financial advice in the first place.

“I think it may be potentially damaging for clients in that, if they are forced to pay on a straight dollar basis, fee for service for the advice they require, then they may find the price goes up,” says John Hart, national manager of financial planners for Sydney-based practice, Centric Wealth. “Whereas in the manner of remuneration currently, cost of advice to clients is subsidised by third parties. I think making advice as affordable for them is very important as they’ve obviously got less ability to afford advice than higher-net-worth clients.”

Hart also believes another result of the banning of commissions will be the separation of fees for financial planning and for funds management, which will mean greater clarity for clients regarding what a particular fee relates to. “It will probably also make it harder for all those agents to bundle fees for different services, and some clients prefer bundling fees for the embedding of discounts,” he adds.

However, the argument that the banning of commissions will result in higher fees for clients is not shared by everyone in the industry.

“Commissions have been an easy smokescreen for the real cost of advice,” says Lap-Tin Tsun, managing director of business transformation consul-

tancy group E&W Strategic Partners in Sydney.

"If the industry truly wants to address the affordability issue, then we need to be smarter and more innovative to deliver advice that is both affordable for clients and profitable for planners."

One thing all industry participants agree on is that the banning of commission-based remuneration represents sweeping fundamental changes to the industry, and how different practices navigate those changes will largely determine whether they will sink or swim.

"This is a significant paradigm shift for the industry, not just a changing of the rules, but a changing of the game," says Tsun. "Many practices are struggling to understand what will happen to them in a commissions-free environment, and some are hoping it will just be a passing moment. The move to a commissions-free environment will, however, shake the very foundation of many practices, and it's not something practices can afford to not start planning and preparing for."

E&W has identified the strategic reduction of operation costs and the rebuilding of the professional and public image of financial planners as being the most crucial issues facing practices if they are to survive in the brave new world.

"The key to a profitable financial planning business in a world without commissions is building a business that, at its core, is streamlined, scalable, and adaptable to the changing environment," says Tsun. "That gives the practice the flexibility and capability to reach out to clients with compelling offers that are not only value-adding and affordable to the client, but also profitable to the practice."

Encore Group's Moylan agrees that being strategic about streamlining costs will be an essential part of a practice's ability to survive the transition.

"Those that are at the forefront understand their costs of production," he says. "The future success is about making this industry equivalent to a manufacturing type operation. In other words, if you know your costs of production then you can actually build the product that will be a winner. At the moment, everyone wants to be in a 100-metre sprint, while the real success stories are the marathon runners. Because planning is about the marathon."

Which brings us back to where we started - the public image of the financial planning industry. If

the public's confidence in the industry is to be properly restored, this is possibly the most critical area of all. And for all the side-stepping, buck-passing, finger-pointing and hand-wringing currently at play, it seems that it's the practices themselves that are the ones who can most effectively bring about that change.

"Despite the reputation of the profession taking a battering from all sides, financial planners cannot react negatively or adopt a siege mentality," says Pritchitt. "Ultimately it is up to individual planners to instigate change and prove that they as individuals are trustworthy and [to] take steps to build their own reputation. They can't adopt a 'someone must do something' approach to the problem - they must do it themselves."

E&W's Tsun agrees that practices need to be proactive. "Some practices, understandably, are taking the 'wait and see' approach, but the danger is that they'll leave it until it's too late," he points out. "Planners that are willing to invest the time and

commitment to prepare their businesses today will be the ones to carve out a leadership position for themselves for the future."

Ultimately though, for all the apparent complexities bobbing up and down like tin ducks in a shooting gallery, the real underlying issue is surprisingly simple; it's just about change, and how different individuals deal with it.

The AFA's Klipin says: "The future is already here; the fact that these issues are on the table means that the value and the benefit of working with a financial adviser needs to be better understood and better communicated."

"Part of being a professional adviser and a business owner, is to understand what the future's going to look like and to adapt to that," he says.

Tsun puts it most succinctly. "It's a game changer," he says. "The ones who survive will be the ones who deserve to." ■

