COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Financial products and services in Australia

FRIDAY, 4 SEPTEMBER 2009

SYDNEY

[11.33 am]

MACKAY, Ms Claire, Director and Certified Financial Planner, Quantum Financial Services Australia

MACKAY, Mr Tim, Director and Certified Financial Planner, Quantum Financial Services Australia

CHAIRMAN—Welcome. I invite you to make some opening remarks.

Mr Mackay—Thank you for the opportunity to appear before your committee. Quantum is an independently owned, successful and growing financial planning firm and training organisation. We are both certified financial planners and chartered accountants and between us we hold bachelor’s and master’s degrees in commerce, economics, law and business administration. Claire is also admitted to the New South Wales Supreme Court.

Australians today are concerned about the financial planning industry, and rightly so. They have seen recurring examples of rampant abuse of consumers and a lack of professionalism shown by the advisers they trusted. From Townsville to Geelong to Perth, if you have not been personally impacted then you will know someone who has been. The focus of our submission is recommending practical reforms. With your help, we can boldly reform the financial planning industry so that consumer confidence and our profession will emerge stronger than ever.

It is time for financial planners to be honest with themselves. As financial planners, we regret the actions of those financial planners who have abused their clients’ trust. As financial planners, we take charge of our own destiny today by proudly and loudly pleading with you to give us an explicit statutory fiduciary duty to our clients. We know that many in our industry are sceptical of how and whether an explicit fiduciary duty will work. There are many complicated issues to resolve but as professional financial planners we can make it work.

It is time to empower consumers and increase competition by turning off the ‘rivers of gold’. It is a sad fact that, in financial planning, he who pays me is my boss. No-one would consider allowing lobby groups to pay fees to politicians, yet we allow product manufacturers to pay financial planners and dealer groups. By ‘rivers of gold’, we mean commissions and any other type of financial arrangement between product providers, platform and dealer groups and advisers. The only parties who resist this reform are those who financially benefit from the rivers of gold.

We recognise that it will be hard, unpopular and costly for many in our industry to undertake this reform. We do not accept that voluntary industry codes are sufficient. This reform is not about helping financial planners. It is about helping consumers. I would now like to hand over to Claire, who, if you were wondering, is my sister.

CHAIRMAN—We weren’t!

Ms Mackay—Quantum's financial planning business specialises in investment, retirement planning, and superannuation advice. We advise our clients. We do not sell them products. It is time to call the salespeople what they are: salespeople. In the interests of consumer transparency and protection, there should be a clear distinction between independent advisers and financial product salespeople. Furthermore, there should be no distinction in the standard to which either is held. They should both have a fiduciary duty to their client. The aim of this is to provide clarity to consumers—not to make it easier for people to sell their products.

It is time for the real financial planners to stand up. We propose the establishment of a professional standards board which is independent, self-funding, with compulsory membership, which sets high and uniform professional and ethical standards. Only members of such a board could call themselves financial planners or financial advisers. Consumers will then have professional titles they can recognise and they can trust. We estimate the cost of this to clients at 1c a day, and we are happy to discuss this further.

It is time to raise the bar. We call on you to raise the financial planning education and experience entry standards. We are proud that our submission is one of the few to recommend how you can practically implement this. We are happy to discuss this further.

As financial planners with a long future before us in the industry, we are passionate and proud of the value we add to our clients. We are honoured to be our clients' trusted adviser. We are the second generation to advise Quantum's clients and we want the next generation to be proud of the profession that today we, together with your leadership, helped reform.

CHAIRMAN—Thank you very much. We really appreciate your submission and the detailed work you have gone to, and your presentation today. Do you think FSR is sufficient, in the way it currently stands, to deal with all of the complexities that are involved in the giving of advice? Do you think there is just enough in there, enough application in FSR, to be able to deal with all of those complexities?

Ms Mackay—From the comments made earlier to the committee, we think the FSR does actually have a fiduciary duty to clients that is imposed on advisers. We think that the regime was a watershed five to seven years ago and it does have the ability to work. It does work.

Mr Mackay—Where it could possibly be beefed up is in the addition of the fiduciary duty. We believe there is an existing implicit Commonwealth fiduciary duty, and we are a bit concerned by other organisations who state that there could be a cost in adding an explicit one if there already is an implicit Commonwealth fiduciary duty. It does concern us somewhat.

Senator MASON—You heard the evidence of the previous witnesses, didn't you?

Mr Mackay—Yes.

CHAIRMAN—Can you just clarify for me: does 'know your client' mean 'act in the best interests of your client'?

Mr Mackay—That is how we interpret it.

CHAIRMAN—That is how you interpret it. But is that what it means?

Ms Mackay—We are not lawyers, but in practical terms if you know your client and you are giving them advice that is appropriate to who they are then it does mean acting in their best interests. I cannot understand how advisers could give advice that is not in the best interests of their client.

CHAIRMAN—But what do you think about the fact that it is absent from FRS? FSR talks about knowing your client. It is one thing to know someone; it is something else to act in their best interest.

Mr Mackay—Correct.

CHAIRMAN—Is that a deficiency?

Mr Mackay—Yes, that is why we are recommending the addition of the explicit fiduciary duty.

CHAIRMAN—You do not take commissions—is that right?

Mr Mackay—We do, on insurance products.

CHAIRMAN—On insurance products only?

Mr Mackay—Yes. It is problematic in that area. We are transitioning to a fee-for-service model. As Claire said, we have a long future in this industry and the recommendations we are making are based on the future.

CHAIRMAN—Why do you not like commissions? What is it about commissions that you do not like?

Mr Mackay—First of all, my belief is that commissions reduce competition. One of the key aims should be that we reduce fees to clients. Undoubtedly the financial services industry is competitive. However, the competition is at the wrong points in the value chain. For instance, typically a client will come in and will be given advice to put their funds into a platform. To do that they will have to pay the adviser fees, the platform fees and the underlying fund manager fees. They will pay between 250 and 300 basis points. That is paid over and then there is a fight between the platform, the dealer group and the adviser on how to divide that pie. It is in no-one's interest to make that pie smaller. It is in everyone's interests to try and get a bigger slice of that pie. Now, if we turn it on its head and get rid of the commissions—and not just the commissions, also the other transfer payments between these bodies—then all of a sudden the adviser now has to negotiate with the client that level of fee. And they are in competition, effectively, with the product provider and the platform for a certain slice of the client's wallet. Do you understand my reasoning?

CHAIRMAN—Yes, I do. In your view would that mean that you could grow the broad market—that more people would get advice—or would it restrict the ability of people to gain advice?

Mr Mackay—I have heard two arguments put forward often. One is regarding choice and the other is regarding reducing access to consumers. I think both are fatally flawed arguments. The first is that consumers want choice. We actually advocated this view until about six months ago. You have CHOICE coming in this afternoon. I would ask you to ask them whether consumers want choice. I am guessing that they would say no.

Mr PEARCE—Did you advocate choice?

Mr Mackay—We did.

Mr PEARCE—What changed your mind?

Mr Mackay—Listening to the arguments that were put forward to us. We came to the conclusion that when clients come in they typically ask their financial planner which ones to choose. They do not come into a financial planner seeking choice on fees; they come in seeking good advice at low cost. Financial planners understand those fees much better. There is an information asymmetry and they have a financial interest in one being selected. So we argue that giving choice to consumers means that you are giving them an uninformed choice—and an uninformed choice is no choice at all.

Secondly, there is an argument put forward that removing commissions reduces consumer access to advice. Firstly, we do advocate that advice fees paid by the client should be tax deductible.

Senator MASON—Should be?

Mr Mackay—Should be, yes. I assume that when some people use this argument what they mean is that consumers would stop paying for advice if they knew how much it was really costing them. They seem to suggest that instead we should continue to hide the cost from consumers via commissions hidden in these products. To us, this seems like an appalling argument for allowing commissions to exist. According to Ric Battellino, the Deputy Governor of the Reserve Bank:

> This reluctance to pay for advice upfront appears to be a form of money illusion, whereby investors may feel that they are somehow paying less for financial advice if the cost is buried in reduced earnings in the future.

CHAIRMAN—How does that work differently for the Storm case, where was the complete opposite. In fact, it was very up front—7½ per cent, in your face, a big fee, straight up front, right now. How does that work?

Mr Mackay—I do not know. I am not completely au fait with how they structured their fees. You are saying that they—

CHAIRMAN—Basically, they had a seven or 7½ per cent up-front fee. You paid it all up front in one hit, straight out of the investment product.

Mr Mackay—Yes. Obviously, there are many issues involved in Storm. We are talking about reforms at the general industry level as opposed to trying to fix the Storm situation.

CHAIRMAN—That is fine.

Mr PEARCE—The chair asked you about commissions. I think the question he asked you was: why don't you like commissions?

Ms Mackay—I think the thing is—

Mr PEARCE—No—you answered it. So, you do not like commissions?

Ms Mackay—We do not.

Mr PEARCE—But if I come to your business today to buy insurance, you would sell me a product with a commission. Have you knocked commissions back?

Ms Mackay—In certain circumstances—we have spoken to our clients about this—if the commission is taken away, it is not necessarily credited back to the consumer's account.

Mr PEARCE—No—but if I come to your business today and I say, 'I'd like an insurance product,' you would tell me that you still insurance products with commissions.

Mr Mackay—For legacy. We accept commissions on legacy products. Typically, for new clients who come in today we charge a fixed fee per year, regardless of insurance or other products we put them into.

Mr PEARCE—Let's say I come in and I have a legacy product, but I am happy to move to you from some previous person, and I have an insurance product with Asteron, let's say, or Tower. You do not like commissions, but you operate in a market where you accept commissions.

Mr Mackay—Correct.

Ms Mackay—We talk about it with the client. For new clients, we do not want to accept commissions. That is the line. For clients who have legacy issues, we work through them. We are transitioning clients across and some clients are saying, 'Look, I don't want to have to write the cheque every month,' or whatever, so I am happy to do that.

Mr PEARCE—So, if I come to your business today and say, 'I'd like to get some insurance. What would you recommend?' you will only recommend to me an insurance product that does not have a commission?

Ms Mackay—No, we would recommend the best product for you in your circumstances that is available in the market.

Mr PEARCE—What happens if it has a commission? Would you recommend it to me?

Ms Mackay—We would obviously—

Mr Mackay—We can set commissions back to zero in some circumstances.

Mr PEARCE—That is my point: will you recommend a product to me that does not have a commission to you?

Mr Mackay—It depends on the circumstances of the client.

Ms Mackay—If you come in and say you want insurance without commission, we would do everything we can to get you the product that is appropriate for you.

Mr PEARCE—Let's take a practical example. You are in North Sydney, aren't you?

Mr Mackay—Chatswood.

Mr PEARCE—Same place! Let's say I walk in this afternoon and I share with you my particular circumstances. You will go about 'know your client' and all of that. I share with you and you find out I have an income, expenditure, and a nine-year-old son and older children who cost me a fortune et cetera, and you will say, 'Chris, I think the best product for you would be X, Y or Z.' Will you recommend that to me if it has a commission?

Mr Mackay—For new clients we do not charge commissions, so, no, we would not charge you any commission on an insurance product.

Mr PEARCE—You won't?

Mr Mackay—No, not for a new client.

Mr PEARCE—Regardless of the product?

Mr Mackay—Regardless of the product.

Mr PEARCE—But if I am a former client of someone else and I have an existing policy—

Ms Mackay—But you are a new client to us.

Mr Mackay—If we can switch it off, we will.

Mr PEARCE—If you can?

Mr Mackay—Yes. If it is repaid to the client.

CHAIRMAN—I think we are clear. They are doing their very best.

Ms OWENS—You are transitioning. You did not say, 'We don't like commissions. We are stopping today.' You are actually transitioning. How difficult was the transition? Are their barriers to that transition? We hear stories that it would be very difficult for the industry to stop doing this. Can you tell us what the experience was like?

Mr Mackay—For the entire industry, yes, we agree that it probably will be very difficult, but that is not a reason to not undertake the reform.

Ms OWENS—Why would it be difficult, from your experience?

Mr Mackay—We use the expression ‘rivers of gold’. It is very descriptive. Earlier, you discussed the fact that it is easy to collect this money, with regard to commissions. Accountants have to chase up their clients. With financial planners it is all played by the product manufacturer. All of a sudden we now, as financial planners, have to chase up money from clients. Also, it means you have to have an ongoing a relationship with that client. You have to offer them a good service, otherwise they will not be prepared to pay it. If there is no service and no relationship ongoing, even though a commission has been paid, it will be hard to transfer that commission into a revenue.

Ms OWENS—So there is an additional cost to your business of chasing the fee?

Mr Mackay—Potentially there is, and there is the lost revenue from clients whom you no longer talk to but for whom you are still getting commissions.

Ms Mackay—The hardest element in the transition across is having that conversation with the client because, for many in the industry, if they have not had a conversation for a while, it is difficult to prove that they are providing value. All of a sudden they are turning around and saying we are now not receiving money from someone you were not aware of or have forgotten, but now we are actually asking for money out of your bank account. That conversation is the difficult thing. I think many in the industry are afraid of having that conversation with their clients because they are going to have to stand up and say, like a lawyer or like an accountant, ‘My time and my professional expertise is valuable and I should be paid for it.’ It is that conversation that professionals have with their clients to justify their value and to justify their payment.

Ms OWENS—But you are able to turn those commissions off in every case if you wish. Are there some products where you cannot?

Mr Mackay—There is an issue with some products in that you can turn the commission off, but it is not then rebated to the client. Then we have to charge them on top of that.

Ms OWENS—Thank you.

Senator MASON—I thank you very much for your submission. I suspect there would be many in your industry that do not enjoy it; nonetheless, I thank you. You believe there should be a statutory fiduciary duty. Is that right?

Mr Mackay—Yes, we do.

Senator MASON—That will certainly clarify the law. Do you think that commissions constitute an inherent conflict of interest?

Mr Mackay—Yes, we do.

Senator MASON—Because it skews the nature of the advice?

Mr Mackay—It can.

Senator MASON—You say on page 5 of your submission:

For example, where an organisation accepts commissions or hidden payments on any financial product it is reasonable to assume (unless otherwise stated) that their submission will support the continued allowance of commissions or propose delaying tactics to protect commissions on those financial products for as long a period as possible.

Is that right?

Mr Mackay—Yes.

Senator MASON—The argument we are hearing consistently is this: if commissions go, disadvantaged people in particular will have less access to financial advice. You have proposed that advice might be tax deductible, which would increase accessibility. But you also said that this would make the cost of that advice apparent rather than hidden. Is that what you are also arguing?

Mr Mackay—Yes.

Senator MASON—Do you think that is a good thing?

Mr Mackay—Yes. I think all fees for advice should be agreed between the financial planner and the client themselves, and the transfer of money should be from the client to the financial planner.

Senator MASON—This would lead to the further professionalisation of the industry?

Mr Mackay—Yes.

Senator MASON—Thank you.

Mr PEARCE—I was impressed by the comments you made about your academic qualifications. You would obviously like to see the bar lifted in terms of qualifications. Can you share with us how you think that would be best structured and what sort of qualifications are involved? Do you think there needs to be a minimum and what would that minimum be?

Ms Mackay—As you are probably aware from other submissions, the current standard for the RG146 qualification is the equivalent of a diploma level. We are currently involved in discussions with IBSA, Innovation and Business Skills Australia, the body that looks after the content of those diplomas, about raising the content and standard. We would recommend that we immediately raise it to an advanced diploma level for new entrants. We will not go into the grandfathering issue. We also recommend immediately imposing an experience component to it.

Mr PEARCE—So that there is some practical experience to it?

Mr Mackay—Yes, so there is an 18-month or a two-year supervised work experience.

Mr Mackay—Just to qualify, we view an advanced diploma at first-year university level.

CHAIRMAN—First year?

Mr Mackay—Yes. It is currently at diploma level.

Mr PEARCE—So you are saying an advanced diploma. Okay. The other question I had was: you made a suggestion, which I think is a very interesting suggestion, about having an independent oversight regulatory body. I presume that you mean something like the AASB—the Australian Accounting Standards Board. Do you mean the same sort of model as that, where it is an independent board with its own ethics, its own benchmarks and its own governance process? Is that the sort of model you are talking about?

Ms Mackay—Slightly. In that one, the individual accountants are not members of that board, so the Institute of Chartered Accountants and the CPAs support that board and adhere to it and impose those obligations.

Mr PEARCE—You want the planners to be individual members.

Ms Mackay—We would like that as well, yes. Similar to what has occurred in the UK.

Mr Mackay—It is what is going on in the UK at the moment and it is also what the financial planning association in America is advocating—a professional standards board over there as well.

Ms OWENS—Is there any role at all for a pure salesperson—a person who sells one product and that is it?

Mr Mackay—Yes. We use the analogy: if you walk into a Ford dealership you should expect to buy a Ford. There are some financial advisers out there who are in a similar situation. There is always a role for them, but it should be made perfectly clear to the consumer that that is the role that they are fulfilling.

Ms Mackay—I think at the moment the concern is that consumers cannot identify who independent advisers are and who are salespeople employed by product manufacturers to sell their product.

CHAIRMAN—Just on the compliance issue, and there are two parts to my question: how do you see compliance and how do you think the industry sees compliance? Is compliance about ticking a box and protecting yourself, or is it about providing protection for your client? How do you see that and how does the industry see it?

Ms Mackay—We actually talk about a compliance culture within our organisation. We see it as embedded in everything we do, because ticking a box is not the essence of what compliance is about. It is not about making sure that the boxes are ticked. We see it as protecting us as licensee, our advisers as authorised reps, and our clients. We see it as uniform.

CHAIRMAN—How do you think the industry works? Is compliance just about ticking the box and protecting yourself rather than focusing on the protection of your clients?

Mr Mackay—I do not feel we are qualified to comment on behalf of the rest of the industry.

CHAIRMAN—That is fine.

Mr PEARCE—You have got an interesting business, it seems to me, in the sense that you hold an AFSL but you are an RTO in your own right as well. Why are you an RTO?

Mr Mackay—We see great synergies between finance and education. As a registered training organisation we do not just educate our clients; we also educate our financial planning clients—

Mr PEARCE—You do. That was going to be my next question.

Mr Mackay—Yes, we do, for those who want to learn more. Some are too busy, some are not interested, but that is a big part of our service: we educate our clients, because educated clients are happier clients, in our experience.

Mr PEARCE—In my own experience, I think that there would be very few AFSL holders who are also RTOs. So I think it is quite an interesting model that you have developed there. I think it is good for your own people as well as for your clients. On that score, how do you attract clients to your business?

Ms Mackay—The majority of them are through word of mouth. Our clients are happy clients and they want to refer us to their friends and family.

Mr PEARCE—You have never had an unhappy client?

Ms Mackay—We have had clients who have been unhappy at times, and we work through the issues with them.

CHAIRMAN—Could I bring you back to education just briefly? You obviously do not try to educate your clients in terms of understanding all the intricacies. You are not trying to give them a diploma-level understanding. It would be impossible. What are you trying to educate them to understand?

Mr Mackay—Risk and return are the two biggest concepts.

CHAIRMAN—How quickly, normally, could you impart that sort of education?

Mr Mackay—It is a process.

CHAIRMAN—Could you, in a reasonably short period of time in a meeting, explain the basic concept if somebody said they really did understand the basic risk.

Ms Mackay—You can begin that discussion, but it is also re-emphasising that with your client. Clients come in with fixed views, and if you are trying to educate them about something you need several discussions.

CHAIRMAN—Can it be done in reverse? You are trying to do the right thing; you are trying to educate your clients to understand risk so they do not take too much risk. Can it be done in reverse, where you can educate someone into taking more risk than they ever dreamed possible?

Mr Mackay—Yes, I do believe that is the case. For instance, if you look at the term 'high yield bonds', they were originally called junk bonds. They are exactly the same product, but it is how you market that product. In that case, the old name 'junk bonds' was focused on the risk. When they changed the name to high yield bonds, all of a sudden the focus was on the return.

CHAIRMAN—So education seminars can be just as much aimed at so-called 'educating' people into taking more and more risk, rather than educating people about what risk is.

Mr Mackay—They could be used in that way.

Mr PEARCE—That is interesting, isn't it? Some evidence earlier from a financial adviser planner was interesting. I would like to contrast this. Again, it is a practical example. Chris walks in again to Quantum Financial Services and we go through the whole process, and I say to you: 'No, but hold on a minute. I've been told by my friend'—you must have this a bit—'that they've invested in A, B, C, and that's where I want to go.' If you deemed that investment to be not in my interests given my profile and all the rest of it, you would tell me that presumably. But what would you do if I said to you: 'No, I want to put some money into A, B, C. I want to put some money into this fund or that fund because Mary or Jimmy my cousin's done that and they've done really well out of it and I reckon it's great.' What would you do?

Mr Mackay—We would go through a process of trying to educate you if we honestly thought that that was the wrong thing—

Mr PEARCE—Against it?

Mr Mackay—Yes, against it. Having said that, at the end of the day, if you are adamant that that is what you want to do, we are your adviser. We do not have any discretionary power over what you can and cannot do, and so if your direction is to do that, then we have to follow that direction. If we feel uncomfortable with that, if it is a massively disproportionate percentage of your portfolio, we would probably say, 'Thank you, but we really can't serve you as your adviser.'

CHAIRMAN—So you give them advice that if they wanted to do this, you would advise against it. But if they really wanted to, you would advise strongly in the direction of just a small portion of their portfolio?

Ms Mackay—Ultimately it is their money. We do not say, 'You can't go spending your money or you can't go put it in a bad investment that we advise you against.'

Mr PEARCE—So you would help me?

Ms Mackay—We would not want to help you, and so, as Tim said, we would either try to help minimise the risk that you would be exposed to or if we cannot do that and you are adamant then that signals a relationship that maybe we do not want to continue.

CHAIRMAN—But you would make it clear though, I think that is the point.

Ms Mackay—Absolutely.

Mr PEARCE—You would knock me back then?

CHAIRMAN—Chris, I am sure you have been knocked back before.

Senator MASON—And it is the second time you have been through the door today!

CHAIRMAN—And on that very good note, thank you very much. We really do appreciate your submission. It was very detailed, of very good quality, as was your evidence.

Proceedings suspended from 12.02 pm to 1.00 pm