In search of advice instead of sales pitches

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Make no mistake. If passed by Parliament, the government's financial reforms will drastically change the way many financial planners are paid.

While much of the talk has been about how consumers should pay for financial advice - whether they should pay a set fee, a percentage of their investment or pretend the advice is "free" while their adviser takes commissions on the investments he or she sells - the quality of advice given also depends heavily on how the adviser earns his or her income.

Research by Investment Trends found 45 per cent of financial planners received none of their income from a fixed salary. That means almost one in two planners are dependent on some form of incentive payment to pay their bills - whether this is in the form of commission, incentives to recommend company products or some other form of payment.

Of the 55 per cent of planners who receive a salary, on average this represents 79 per cent of their income. A minor portion might still depend on what the government is calling conflicted remuneration.

In a nutshell, conflicted remuneration is any form of payment to advisers that could encourage them to sell you products rather than make recommendations in your best interest. It is a form of remuneration the government wants to stop.

This week it released the second tranche of its financial advice legislation, banning many of the pay practices that revolve around selling products rather than providing genuine advice.

Along with its much-touted ban on commissions (though only on new investment products sold from July 1 next year), the legislation bans more insidious payments such as incentives to flog in-house products called soft-dollar benefits (free trips and other goodies worth more than $300). Some of the less-savoury payments used by investment platforms, such as "shelf-space fees" paid by fund managers to get preferential treatment for their products and volume-based rebates that reward advisory groups for being big customers will also go.

Importantly, while the legislation did not go so far as to ban asset-based fees, in which investors are charged a percentage of the value of their investments, regardless of how much work is done, these fees will be banned on geared investments to remove the incentive for advisers to encourage clients to borrow more to line their own pockets.

With the bulk of planning groups now owned by financial institutions, the reforms should help shift the focus from advisers being regarded as distribution channels for those institutions to something more customer-focused.

With the exception of basic banking products, financial institutions will be banned from paying their employees incentives to meet targets such as selling a particular amount of product. The Investment Trends research found that though 44 per cent of advisers received no financial or other incentives from their licensee to recommend in-house products, most did. A senior analyst for Investment Trends, Recep Peker, said 26 per cent received a financial incentive, 14 per cent a non-financial incentive and 16 per cent a combination of the two. The most common non-financial incentives included restricted product lists, encouragement by management and better support and training.

While the government cannot do much about restricted product lists and management "encouragement", the reforms will break the connection between what the planner earns and how much of his employer's product he flogs, which can't be a bad thing for investors.

The legislation will also stop some of the excessive soft-dollar benefits that have been used by providers of financial products to motivate and reward planners for selling products. Some of the more obscene examples have included extravagant overseas junkets labelled as "professional development" - with little training or development involved.

The industry has already moved to crack down on these types of excesses and Investment Trends found just 7 per cent of advisers had received cash, gifts or entertainment valued at more than $300 from third parties last year.

Overall, 55 per cent of advisers said they had not received any soft-dollar benefits from a business other than their dealer group in the past year and where they had, this had typically involved professional development, technical or compliance services. Nine per cent of those who had received soft-dollar benefits said they received conferences or sponsorships, including accommodation or travel, that was volume based.

The ban on soft-dollar benefits worth more than $300 will have exemptions for education, training and technology support but these benefits will have to be the real thing. The legislation says any professional development provided must be in Australia or New Zealand, with 75 per cent of the time spent on professional development and expenses such as travel, accommodation and transport paid for by the adviser or their employer.

When it comes to the investment platforms - products such as master trusts and wrap accounts that advisers like to use as a central repository for their clients' investments - the changes should be of benefit to consumers.

The industry has lobbied hard against the bans on volume-based rebates and similar payments, as well as the ban on shelf space fees paid by fund managers to get access to the platform or preferential treatment for their products. The legislation still includes the bans, but with exceptions for genuine discounts given to fund managers for scale benefits. The discounts will have to be in line with the savings generated by the scale of their business.

Commissions are just the most obvious face of conflicted remuneration. These other practices are less obvious to investors yet potentially just as damaging. Planners need to be paid for the quality of work they do for their clients, not to flog products.