

AMP the fifth pillar?



By Alan Kohler

PORTFOLIO POINT: Adding AXA would put AMP ahead of banks in wealth management and create a sales force of more than 4000 just as a crunch looms in financial planning.

AMP's \$11 billion bid to swallow the local arm of AXA is a desperate response to the revolution that people like Tim and Claire Mackay are bringing to financial planning in Australia. But it won't work.

Tim, 37, and Claire, 34, are the children of Bill Mackay, who set up a financial planning firm called Quantum Financial Services in Chatswood, Sydney, 15 years ago. They have seven degrees between them, including MBAs, they're both chartered accountants and certified financial planners, and they represent the bright future of financial planning.

Bill wouldn't let them join the family business until they had proved themselves outside, which they have now done. With their father, they are now pushing for change in their chosen profession.

As Tim told me this morning: "I want to be proud to call myself a financial planner. Claire and I are the future of this industry and just as chartered accountants used to be best known for bottom-of-the-harbour tax schemes in the 1970s and have now rehabilitated their reputations, we think financial planners can do the same thing."

It's because of individuals like Tim and Claire Mackay that Eureka Report's long campaign against commissions and conflicts of interest in financial planning is now coming to fruition, and it's also why AMP wants to take over AXA Asia-Pacific.

Tim, by the way, is also on the regulatory sub-committee of the Financial Planning Association, and the submission penned by Bill, Tim and Claire Mackay to the Ripoll Inquiry into Financial Products and Services (the inquiry is examining the role of financial advisers in recent failures such as Storm Financial, MFS and Opes Prime) is the best explanation of the problem, and the solution, that I have ever read. I quote from it at length below.



There is now huge pressure coming on the big financial services operators like AMP, AXA and the banks over the amount of money they have been skimming from Australians' savings for the provision of financial "advice", which much of the time is simply sales.

Commissions represent 61% of financial planners' incomes and, in my view, are almost certain to be banned.

And if the Australian Securities & Investments Commission has its way, fees based on a percentage of funds under advice – another 23% of planning incomes – will also be banned (less likely, in my opinion).

With 84% of financial planning incomes under threat, no wonder AMP wants to get bigger. As ASIC said in its submission to the Ripoll Inquiry: "ASIC considers that it would probably cause some consolidation within the advice industry ..."

AXA's independent directors, led by Rick Allert, have rejected AMP's first bid as inadequate, but like the Canadian bid for Transurban, it's just an opening gambit. Having declared his hand, AMP's Craig Dunn will not give up easily on putting AMP and AXA – the old National Mutual – together. As AMP chairman Peter Mason said in his letter to shareholders this morning: "It is early days".

These companies own the two biggest financial planning networks in the country: AMP employs more than 2000 financial planners; AXA close to 2000. Together they will have more than 4000.

Each says its financial planning division provides "advice-based sales" and in each case these networks arose out of the life insurance sales forces of AMP and National Mutual. Their planners are a mixture of excellent, well-educated modern financial advisers and old insurance salesmen, but they are all assessed by the amount of financial products they sell – whether AMP's and AXA's own funds, or other funds, sold on commission.

These are very effective, highly motivated distribution networks. Putting them together would create the most powerful sales force for investment products Australia has ever seen.

As AMP chief executive Craig Dunn said today: "The proposed acquisition would ... accelerate our strategic drive to broaden and diversify our distribution capability. In addition to doubling the number of aligned AMP planners to more than 4000 across Australia and New Zealand, this proposed transaction would substantially increase the number of relationships with non-aligned financial advisers."

The deal would create a "fifth pillar" in financial services, vaulting AMP past the banks in each of the financial services sectors, giving it 25% of the retail superannuation market, 18% of retail managed funds, and 17.6% of retirement incomes. CommBank and NAB lead each of these businesses now.

That's the positive spin on the deal; the reality is somewhat different.

Australia is in the process of redefining how financial planners are paid and how financial products are distributed. Eureka Report's long campaign to separate sales from advice,

and to ban sales commissions paid to financial planners, is finally coming to fruition.

The Parliamentary Joint Committee Inquiry into Financial Products and Services – the Ripoll Inquiry named after its chairman Barry Ripoll – is due to report in a couple of weeks, having conducted nine public hearings and reviewed hundreds of submissions, most of which were about the collapse of Storm Financial.



The most explosive submission to the committee was from the Australian Securities & Investments Commission, which proposed to ban:

- Up-front commissions.
- Trailing commissions.
- Soft-dollar incentives.
- Volume bonuses.
- Rewards for achieving sales targets.
- Fees based on a percentage of funds under advice.

As they started reading those six items, financial planners would have become increasingly hot under the collar. But the last one would have had them spraying their cappuccinos all over the room.

Those in the industry, including planners at AMP and AXA, who have been reluctantly accepting the idea that commissions would have to go, have been seeking refuge in the notion of “fee for service” involving a percentage of funds under advice.

In its submission, ASIC estimates the percentage of financial planners’ incomes from that kind of fee for service at 23% of all income. Trailing commissions are still 35%, up front commissions 26%, and just 16% from hourly rates.

Meanwhile, former ASIC deputy chairman Jeremy Cooper, who is now chairing the government’s super system review, has provided some support for his old employer’s position.

The issues paper released a few weeks ago estimates that fees for superannuation funds management – based, as they are, on a percentage of funds under management – increased at a compound rate of 14% per annum between 1996 and 2006, compared to GDP growth during the same period of 5.8% per annum.

The fact is that outfits like AMP and AXA, as well as the big banks, have had it too good for too long, and the party is over.

But it’s not just about the amount of money being skimmed from Australians’ savings by these organisations but the damage they have done to the reputations of all financial planners, particularly the good ones, who care about their clients and want to do the right thing.

Their problem is that they work in an industry that is based on sales, not advice, and it is very difficult for them to break out of that.

AMP, AXA and the banks have corrupted the words “planner” and “adviser”, so that those who are genuine planners and advisers, rather than sales people, are having a lot of trouble breaking out.

Rather than go on about this myself, I should let the Mackays speak; they do it far better than I ever could.

“Obviously we, like many of our colleagues in the industry, have business and revenue bases to protect. Many of our colleagues in five, 10 or 15 years’ time will not still be active in the industry – instead hopefully enjoying well-deserved retirement with grandkids and pursuits.

“However, as most Quantum Wealth Advisors are members of the younger financial advice generation with 30+ years ahead of us in the industry, it would seem short-sighted for us to just focus on current revenue protection.

“For full-disclosure purposes, Quantum’s business model currently allows/accepts commissions and we actively have argued in the past that clients should have the choice of commissions or fee for service.

“However, today we believe that if we:

- Defend commissions,
- Argue that commissions should be phased gradually out,
- Argue that commissions should be grandfathered, or
- Argue that commissions should be legacied,

then we are taking a lazy approach and we are not being proactive in justifying to our clients and potential clients that our advice services are truly worth paying for.

“We note that lawyers used to charge by the length of advice on a per-word basis – and obviously clients could see it was in a lawyer’s interest to write lengthy advice. The standard billing process is now hourly rates with accurate fee estimates. Large accounting and law firms provide fixed-fee costs (based on estimate of time spent) and work to that budget (and take the hit if costs exceed the quote).

“Our submission to the [Ripoll Inquiry] is not focused on protecting our current revenue base as we believe this would undermine the valid arguments we put forward. Rather, we acknowledge our own existing biases and we are attempting to make a submission that is in the best interests of the industry going forward, and most importantly, consumers as a whole.

“The failures of financial institutions, rampant consumer abuse, and widespread investor anger against the financial planning industry have created a lack of public trust in our financial systems. In recent years some of our fellow financial planners have done things that are unethical and wrong. As

financial planners ourselves, this saddens and embarrasses us.

“We need to rebuild the trust.”

Here are the Mackay family’s seven recommendations for reform:

Recommendation 1: Introduce regulatory changes to prohibit product providers from setting remuneration terms for intermediaries and require intermediaries to set their own remuneration arrangements with consumers.

Recommendation 2: Empower consumers by enabling them to stop paying financial planning advice-related commissions and/or fees at any time, at their discretion.

Recommendation 3: Introduce regulatory changes to ensure consumers can distinguish between independent investment advice and sales-driven financial product sales.

Recommendation 4: Regulate and restrict the use of the titles “financial planner” and “financial adviser” (we use these two terms interchangeably).

Recommendation 5: Enforce and review existing disclosure rules regarding the term “independent” and ensure the compulsory full and clear disclosure of all related parties.

Recommendation 6: Increase financial planning education and experience entry standards.

Recommendation 7: Establish a new, overarching Professional Standards Board, with similar powers to standards boards in other professions; membership of which is compulsory and a Code of Ethics.

They probably wouldn’t be exactly my recommendations for reform. I’d probably have a legislative ban on commissions, but I suppose Recommendation 1 would have that effect.

The trouble for AMP is that even if it does take over AXA and become the “fifth pillar” in Australian financial services, the new status won’t do it much good if the “advice-based distribution” model comes to an end.

And it will come to an end if there are enough Tim and Claire Mackays giving independent advice, and proudly calling themselves financial planners, not distributors of products. No one will go to AMP’s 4000 “advisers” then. ◆