

Financial planners scrap commissions in favour of upfront fees: a welcome move, but government regulation still required, say commercial lawyers.

The recent collapses of Great Southern, Timbercorp and Storm Financial have been the final nail in the coffin for some investors who, in the last twelve months, have sustained huge financial losses.

Today, the Investment and Financial Services Association introduced a new code for financial planners which scraps commissions in favour of transparent upfront fees. However, Maurice Blackburn Senior Associate, Alina Humphreys explains that there is still a clear need to enshrine in legislation mechanisms which provide greater protection for investors

“Increasingly, firms such as ours are seeing growing numbers of people who have suffered enormous losses by following the advice of their financial planner. These people range in age and stage from the young tradesperson, to the dual-income couple with teenage children, to the semi-retired self-employed businessmen. These people have one thing in common: they have all received financial advice designed to benefit their advisor – not them

“Typically, these people were encouraged to ‘save tax’ by buying units in Managed Investment Schemes (MISs) financed by long-term, high-interest loans. Agribusiness MISs, particularly those peddled by the recently-collapsed Timbercorp and Great Southern, were favoured by financial planners and accountants because of the high upfront commissions, often up to 10%. Because these investors were encouraged to ‘save tax’ every financial year, the number of MIS units they owned and, consequently, their number of MIS loans, increased sharply. Some of these people now have monthly MIS loan commitments that exceed their monthly salary.

“On top of this, some agribusiness MISs had substantial yearly or quarterly management fees financed through further loans, the results of which have been disastrous for investors. Timbercorp, for instance collapsed on 22 April, and it is still unclear whether unit holders will make any returns on their initial investments. Some people have repaid thousands on their MIS loans, and will probably have nothing to show for it,” Ms Humphreys said.

A recent report by Rice Warner Actuaries found that clients could pay up to 13 times more to a commission-based financial planner than a fee-only financial planner. This comes on the heels of a Financial Ombudsman Service report indicating a 117% increase in complaints against financial advisors for the last six months of 2008 compared to the same period for the previous year.

“What has become apparent is that there is a clear need to overhaul the current system, to ensure that buying financial products is separated from seeking financial advice.

“The financial services industry has today indicated that it acknowledges that there is a need for greater transparency. The question that arises, though, is how can investors trust that this code will protect them, any more than previous codes? And will it over time, be eroded, as economies rebound from the global financial crisis?

“It is for this reason that the Federal Government must ensure, through legislative means, that the rights of investors will be protected beyond a code established by the industry,” Ms Humphreys said.

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