

First published in the Sunday Age on 1 August 2004

Soft dollar commissions

With great fanfare, the funds management and financial planning industries launched their soft dollar code of conduct this week. Due to take effect from tomorrow, it promises a ban on certain types of so-called 'soft dollar' remuneration paid by fund managers to financial planners. While it's an important step forward for an industry which had previously staunchly defended these payments, it's by no means the massive shift heralded by the self-congratulatory press releases.

Plainly speaking, the code doesn't go nearly far enough. Sure, it bans certain arrangements – volume-related gifts and payments worth more than \$300, but there are flaws in the scope and operation of the ban, and the sneakiest soft dollar arrangements have dodged the ban altogether.

In its recent report on these payments and arrangements, the Australian Securities and Investments Commission identified eleven categories of payment, ranging from cash gifts and travel to complex profit-sharing arrangements, sponsorships and loans potentially worth millions of dollars.

Let's not beat around the bush as to what these payments and arrangements are for. They are bribes paid on top of the standard fees and commissions earned by financial planners. They are designed to build business for the fund manager by providing lucrative incentives for financial planners to recommend particular products.

Whether they take the form of overseas cruises, lavish lunches, business loans or 'buyer of last resort' deals, they are done to generate larger inflows of investor money to the paying fund's coffers. They've been around for years, and aren't only present in financial planning, with mortgage brokers another sector on the receiving end of such payments from our largest financial institutions.

Soft dollar arrangements clearly give rise to substantial conflicts of interest. They are the most egregious example of the 'structural corruption' identified by the ACA when we launched the results of our joint study into the quality of financial planning advice last year.

A consumer seeking financial advice reasonably expects his or her needs and circumstances to be paramount in the recommendations and strategic advice provided by his or her financial planner. After all, consumers already pay handsomely for that advice in the upfront and trail commissions attached to the investment.

The new Financial Services Reform Act requires all factors capable of influencing advice to be disclosed to consumers. Soft dollar commissions fall squarely within this. The FPA/IFSA Code does take this one step further by banning such volume-related bonuses as the luxury cruises identified in the ASIC report.

But the code leaves out other categories of soft dollar identified by ASIC, and which are more insidious because their complex nature makes them difficult to disclose in a way that a consumer will appreciate the extent of influence they are designed to exert.

Take 'buyer of last resort'. The name alone is indecipherable industry jargon. It's basically an arrangement where a fund manager guarantees it will buy the financial planning practice when

the planner decides to sell if there is no other buyer willing to pay the asking price. That price will multiply in line with business generated by the planner for that fund manager.

It's hardly the sort of arrangement consumers expect to be underpinning product recommendations being made by the planner. Disclosure isn't going to cure that sort of practice because it flies under the radar of consumer comprehension. Fee-sharing arrangements are another complex form of soft dollar influence not necessarily based on volume sales and therefore not banned under this code, but potentially worth millions of dollars.

These examples demonstrate how creative the industry has been in designing incentives to promote product sales, and are proof that attempting to prohibit some conflicts while allowing others will not work to cure the corrupting influence they can wield over the integrity and quality of financial planning advice. Relying on disclosure as a regulatory control merely allows the industry to have its cake and eat it too.

There is one possible way out of this mess. New Corporations Law legislation ('CLERP 9') contains a requirement that financial planners and funds manage conflicts of interest – and that can mean avoiding the conflict altogether. Soft dollars are the most obvious candidate for this restriction. If the industry really wants to take a tough line on soft dollars, then in the words of one commentator, it “doesn't have to keep confessing its sins. It just has to stop committing them”.

Catherine Wolthuizen is Senior Policy Officer - Financial Services, with the Australian Consumers' Association, an independent NGO which accepts no external funding, relying instead on subscriptions to its publications *Choice* and *Choice Money and Rights*.