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The Federal Government Tacitly Approves Conflicted Financial Advice

The announcement by Josh Frydenberg that commissions for selling listed investment funds (commonly LICs or LITs) will be banned is being spun as a win for consumers seeking independent financial advice. Whilst that is superficially true, this is yet another case of vested interests in the financial industry being prioritised over consumers. The Federal Government has deliberately chosen to ignore the obvious conflict created by commissions being paid to advisers who sell debt, hybrid, REIT and equity securities to their clients. Despite these commissions being known to distort investments decisions, the Federal Government has given clear approval for these commissions to continue.

The debate over commissions has raged for many years, with the Federal Government previously ignoring ASIC advice to ban this type of conflicted remuneration. The flurry of new debt and equity focussed listed vehicles in recent years has antagonised many, who rightly pointed out that without commissions these vehicles either wouldn't have existed or would have raised far less. This created an imbalance where some listed funds paid commissions to raise capital, whilst unlisted funds didn't. Clearly something had to be done.

In January, the Federal Government called for a rapid consultation with submissions requested. I made a submission and I know others that did likewise. The submissions should be available for review soon. It is unclear what happened after this, as I and those I know did not receive any meaningful correspondence seeking further information. The unwillingness to talk through the issues with those holding different opinions and making different suggestions was not a good sign on how the process was being conducted.

A wide consultation on conflicted remuneration was necessary as the rorts had taken hold long before the wave of listed funds started. A small minority of advisors has long implemented a portfolio churning strategy with hybrids, always buying the new securities to replace existing holdings. This earns the advisor a regular stream of additional income, but the new hybrid often isn't the best investment available. Older hybrids sometimes offer a better margin and/or shorter term, which an unconflicted advisor would choose.

Similarly, advisors who purchased Axsesstoday or Virgin Australia debt securities for their clients have almost certainly caused their clients to suffer substantial losses. If bought at issue and held to default, the losses are expected to be more than fifty times the usual commission paid to advisors. It would be naive to think the same behaviours seen with debt and hybrid securities aren't occurring with equity securities.

The Treasurer's announcement leaves unanswered many questions those focussed on the best interests of consumers are still asking including;

- Why are commissions still allowed on debt, hybrid, REIT and equity raisings?
- What action will the Federal Government take to stamp out the rorting associated with these commissions?
- Does the Federal Government think that the minority of advisors that were improperly influenced to sell listed funds won't switch to selling other commission linked products?
- What clear warnings will be required when brokers or advisers are spruiking commission linked securities to their clients?
- Why are commissions necessary to sell listed securities when the unlisted bond market doesn't require these?
- Doesn't the fact that a commission is required to sell a product indicate that it is lacking sufficient features to be attractive on a standalone basis?

For those who have been following the way consultations have been conducted (or not conducted) in recent months the sub-optimal outcome here is a continuation of a trend. Two rounds of changes to insolvency legislation have effectively given companies a green light to steal from their employees, trade creditors and taxpayers. Here lawyers and company directors won the day whilst those that supply their goods and services to businesses were ignored. The immediate result was that some big businesses have used their newly acquired powers to refuse to pay their suppliers, cutting off cashflow to some of the businesses the government claimed it was helping. All this goes to show that best return on investment for any business is expenditure on lobbying government.

Footnote: in giving a brickbat to the Federal Government for poor consultation processes it would be unfair to not give a bouquet to a recent example of excellent process. In developing initiatives to support competition in lending from the securitisation sector, the politicians and public servants involved have conducted open consultations that deliberately sought out a broad spectrum of industry feedback. This is to be commended, particularly the work of the AOFM in very trying times.

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Disclosure