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Hopes for conflict-free advice lie with Australia

By Tom Stabile

Ask investors in the market for financial advice to map out their ideal terms, and there are a few traps they would avoid: conflicts of interest, inferior products, hidden fees, shenanigans.

That is a long way from where we are today. It is hard to find that happy place where advisers are primed to offer clean guidance and strong-performing, suitable products without some institutional bias creeping in, or some form of baked-in fees clouding the end-costs to clients. It does not mean there aren't plenty of honest advisers in the good fight, but the game is rigged against them.

The good news is that many of the world's major economies have at least embarked on regulatory reforms for the advisory business. Only one of them, however, holds hope to greatly curb conflicted advice and other unhealthy practices.

It isn't in the US. The Dodd-Frank Act reforms that federal regulators are sorting out were supposed to stem investor confusion about the different types of advisers on the market and require all of them to follow a uniform fiduciary standard of conduct to act in a client's best interests. The leading proposal on the table, however, would essentially stretch the standard's definition to also cover many of today's common sales practices.

And none of the Dodd-Frank reforms would sweep away cobwebs of conflicts deep in the US advisory business. A prominent example is how most brokerages not only earn fees from their advisers' clients, but also enjoy revenue streams or other benefits from the external money managers that supply them with investment products.

Whether it is fees to attend conferences, costs to support advisers with market intelligence, or due diligence process charges, the payments collected in cash or in kind from asset managers certainly muddy the waters – and hide the real price of investment advice from clients.

The promising stop isn't in Europe either, despite waves of reforms. The UK is still figuring out details of pending rules for all independent advisers to use a fee-based model and scrap commissions. And the European Community has been inching toward stronger investor protections for several years, including the Markets in Financial Instruments Directive, which is currently under review, and recent requirements to put many pieces of the advisory relationship into writing.

Still, a private banking model remains across much of the continent in which a client

indulges on seemingly low fees but may end up with weak products and conflicted advice when banks push their own funds or when they accept payment from external distributors, in one form or another, to stock the shelves with their funds.

No, the boldest restructuring is nowhere near the US or Europe, but instead is farther away, down under. Australia's Labour-led minority government has drafted a series of steep reforms that it aims to get through Parliament later this year, and several would shake up the status quo for retail advice to individual investors.

One would require financial advisers to have clients "opt-in" every two years to continue the relationship – an effort to jolt investors into asking whether they are getting what they need and the best deal available.

Other changes would outright ban trailing and upfront commissions, as well as payments from a fund manager to wealth advisers that are triggered by the amount of product they sell to clients or by sales targets. Along with a stricter cap on "soft dollar" benefits and the duty to act in a client's best interests, these shifts would reset practices across the financial advisory landscape.

The key hitch separating Canberra's wholesale changes from reforms elsewhere round the globe is the idea that transparency sometimes just isn't enough to foster responsible practices and guard investor interests. Saying that conflicted relationships or embedded fees are fair as long as they are disclosed on page 19 of a thick form effectively exploits the many investors who are not attentive or savvy enough to grasp that they are not getting clean advice, and are unable to judge when they are being served well or fleeced.

Today's disclosure framework falls too short far too often. A sensible next step for advisory businesses in the US and Europe might be to direct advisers to verbally outline their conflicts in stark, blunt terms for all transactions.

That change would be dramatic, but nothing like the higher bar Australia may soon set for the rest of the financial world.

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