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The hidden sales scandal

SPECIAL INVESTIGATION

Excessive commissions, free holidays and biased deals are plaguing financial advice in New Zealand, a Sunday Star-Times investigation has found. Rob Stock reports.

Customers of insurance and investment advisers are being sold expensive products not knowing that hidden incentives have distorted the advice they receive.

The undisclosed deals often take the form of extra commissions for reaching volume sales targets, and luxury overseas holidays are offered to advisers with the best sales.

The incentives are so generous that commissions in New Zealand are among the highest in the developed world, adding as much as 30% to the cost of some insurance products.

"Soft dollar" volume incentives -such as competitions at Tower and Sovereign offering Rugby World Cup trips for insurance advisers who place the most business with them - are pure sales strategies designed to induce advisers to provide biased advice to their clients, but the practice is effectively secret because insurance and financial advisers routinely do not tell clients about them, or disclose them as "educational trips".

Fidelity Life took its best sellers to Egypt last year and this year plans a luxury cruise on the Queen Mary. AIA will take advisers to Hong Kong at the time of the Rugby Sevens. Asteron is planning to take its best brokers on a five-star tour of India. Tower has taken clients to ski in Whistler in the US, while AXA has taken advisers to Tahiti.

Insurers run league tables for the competitions so advisers know where they are in the rankings, and how many policies they need to sell to win a trip.

There can even be first and second divisions. For example, smaller advisers unable to deliver the big volumes at Sovereign can compete for a trip to Malaysia instead of the Rugby World Cup.

The widespread use of such practices in the insurance industry has emerged after a Sunday Star-Times investigation into commission levels in the financial services industry. Some advisers say such trips are rife in other sales industries, and that they are rewards which do not necessarily skew advice.

Detractors say advisers shouldn't liken themselves to salespeople and soft commissions tarnish the image of the industry and undermine the quality of advice.

Allan Morris, a director of insurance adviser Triplejump, said: "To avoid conflict of interest, soft commissions, performance (volume, profitability) bonuses/over-riders should be ruled out, overseas and domestic holidays should be ruled out. Equally, paying for in-house training and in-house systems development should be ruled out."

But Wellington financial planner Alison Renfrew said such trips were not in themselves a problem. "The client needs to know why products have been recommended based on research and needs to be given choices which are then discussed. I do not believe any of my clients would be disappointed to learn that because we work hard some firms choose to reward us via trips." She also did not believe it was reasonable for advisers to have to disclose such trips, because there were so many of them, disclosure statements to clients would have to be enormous and would take hours to explain to clients.

Such trips were also small beer compared to the cost of commissions, says Steve Bloomert from Tower - as little as 1.5%. Milton Jennings, chief executive at Fidelity Life, said they were far less extravagant than in the 1980s and 1990s when mutual insurers did not have to keep such tight reins on the bottom line.

Inquiries also showed advisers are routinely failing to disclose details of volume agreements to clients. Under volume agreements, bonuses are based on the volumes of business done.

But instead of setting out how that works for clients, advisers tend to show only the commission ranges offered by each company, as are shown in the table on page D5.

Those figures appear to show an adviser can be paid equally well no matter which product they sell, when that's not true.

AMP, whose "aligned" network of 80 advisers puts around 80% of all clients into the firm's insurance and investment products, said its advisers tended to disclose ranges of commissions on all products.

AIA does not offer volume-based commissions, a policy introduced in 2006 after its American parent company AIG was found to be rigging the quotes advisers offered US clients, and that it had been paying "contingency" commissions - essentially volume-based commissions - that were being kept secret from clients.

Since then many brokers had turned their back on AIA because its commissions were seen as too skinny.

Ed Saul of Pinnacle Life, which also does not do volume agreements, said they had helped contribute to the high cost of commissions in New Zealand, which Investment Savings & Insurance Association chief executive Vance Arkinstall said were among the highest in the developed world.

Saul says the cost of commission across the industry adds 25%-30% to the cost of life insurance.

But Arkinstall said volume deals should not be banned, and that the duty to provide good advice rested with the adviser, not the insurer.

Currently, weak consumer protection laws mean financial intermediaries are required to disclose fees and commissions only when asked, and only then on certain types of products, and there's no policing of what they are telling clients.

Reliance on disclosure is the New Zealand mantra for fixing the perceived conflicts of interest in the sector, but tougher disclosure rules governing all financial intermediaries could be five years away, and where they have been introduced, such as in Australia, critics argue they have not worked.

David Whitely from the Industry Funds Association in Australia, which provides top-performing super funds that are run on a not-for-profit basis and do not pay commission to advisers, says tougher disclosure rules in Australia have done nothing to stamp out conflicts of interest.

"According to super funds ratings agencies, the most recent data shows nine of the top 10 best performing funds over one and five years are industry funds. But not one of the top 30 financial planning companies recommends them because they don't pay commission," he said. "There's a huge conflict of interest. Advisers have to choose whether they give advice that's in the best interests of their clients or which pays them commission, and they choose commission every time."

A study by the Australian Securities & Investments Commission found that in 4900 super fund switching recommendations given by advisers, 90% recommended a switch to a related fund on which they earned commission. In many cases they made only generalised references to costs and failed to report on lost benefits.

Whitely said the only way to turn what was in effect a sales channel for product producers into an independent professional advice channel was to change the law to require financial intermediaries to act in the best interests of their client.

Overnight, commission as a form of remuneration would disappear, he said, though he admitted the Australian government was not a supporter of such a move.

Insurers and advisers here say if that happened the advisory community would be decimated, particularly the insurance sector, as people simply did not want to write out cheques for advice.

Improved disclosure for all financial intermediaries is still around five years away.

Morris said: "2012 seems and is an inordinately long time away. Certain aspects of the regulation timetable could have an earlier effective date than 2012. For example why cannot agency disclosure, conflicts, fee disclosure be introduced in 2008/2009?"

Fee-based financial planner Robert Oddy fears intensive lobbying by powerful industry groups could result in a watering down of tough disclosure proposals which would require volume agreements, hidden margins and soft-dollar commissions to be fully disclosed, as well as advisers of all kinds setting out in dollar terms the impact on returns of their commissions and fees. Advisers would have to provide "health warnings" on the limitations of the advice they gave.

Arkininstall said members had changed their stance and now supported full disclosure of commissions.

In part that stance has come from insurers being trapped into paying unsustainably high commissions to a dwindling number of advisers.

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