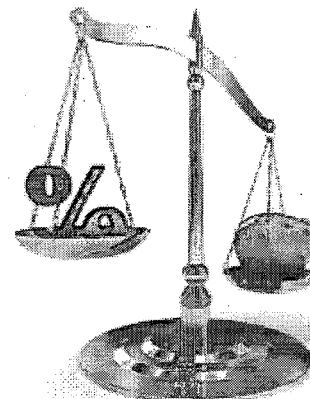


## Wealth Management: An Industry in Need of a Makeover?

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It's hard to imagine an industry with a bigger image problem than the banks, but sections of the wealth management industry are giving them a run for their money. While double-digit returns for many superannuation and managed fund clients this financial year should help soften the blow, the perceived self-interest of wealth managers is continuing to draw criticism. For years many wealth managers have been seen as being more concerned with making as much money as possible for themselves, rather than for the millions of people who entrust them with their life savings.

"One of the real marks of the immaturity of the wealth management industry was during the reporting of the worst returns in history when they were still discussing how much they should be paid," says Alex Dunnin, head of research at financial services information company Rainmaker. "What they should have been doing is working out what value is, and how they could best deliver it to their customers. Here is an industry with a massive future – because all the savings through compulsory super have to go somewhere – but it is a lazy industry because it has so much money going into it."



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Dunnin says the strong recovery in financial markets may have restored confidence to the industry and investors, but it has not changed many underlying issues of efficiency and greed. And while the recent reforms announced by the federal government – including a ban on all commissions paid to financial advisers for advice given on superannuation and managed fund products – will address some potential conflicts of interest, other problem areas remain.

The Australian funds management industry is estimated at about A\$1.4 trillion, of which A\$1.2 trillion is people's retirement savings. Almost A\$10 billion a month flows into superannuation through the compulsory 9% superannuation guarantee levy, paid by all employers on behalf of employees, and through voluntary contributions. About A\$6 billion worth of super contributions is being handed to fund managers to invest monthly. The rest is with the DIY – or self-managed – super sector, which is more likely to make direct investments in equities, cash and property than in managed funds.

The constant flow of money into self-managed superannuation funds (SMSFs) should act as a wake-up call to the rest of the wealth management industry as it grapples with a range of issues, including gross inefficiencies, high fees and investor mistrust, Dunnin says. "Wealth managers have to find a way to work with the SMSFs because, as the DIY sector is growing, wealth managers have a diminishing role," he says.

The Australian Taxation Office reveals there are now more than 410,000 SMSFs with assets totalling more than A\$330 billion, making it the largest sector in the superannuation industry. And the numbers keep climbing with about 2,500 new self-managed superannuation funds being set up each month. Hugh Dougherty, head of manager research at Towers Watson's investment business in Australia, says the wealth management industry has been "sleepwalking its way through the last 20 years". The challenge for much of the industry will be the rebuilding of trust, where people's retirement savings are not treated like some commodity that can be degenerated, he says. "The global financial crisis was the tipping point where a lot of people over-promised and under-delivered – they under-delivered for the client, but over-delivered for themselves."

### The Blame Game

Pengana Capital co-founder and fund manager of small caps Steve Black says the industry's poor image

goes hand in hand with what happens after a massive decline in fortunes. "People have to look for someone to blame. Whether that is justified or not is another question." The current self-analysis of the industry as part of two significant government reviews – the Super System Review chaired by Jeremy Cooper, former chair of the Australian Securities and Investments Commission, and the review of Australia's future taxation (including superannuation) headed by Treasury secretary Ken Henry – was both necessary and well-timed. It should result in more controls and compliance in areas such as risk and the generation of fees, Black says. "It is a necessary evolution of an industry that is still very young, despite its relative size," he says. "A positive from the global financial crisis is it has provided a catalyst for change – but we have to make sure we go about it the right way. More controls may mean more costs and, maybe, a drain of talent on the industry if some of the returns that have been available are removed."

Peeyush Gupta, co-founder of financial advice firm ipac securities and executive in residence at the Australian School of Business, points out the wealth management industry was well on the way to professionalising itself before the financial crisis. Moreover, on a worldwide basis, the industry compared well. "Disclosure laws in Australia, which require all fees and commissions both upfront and ongoing to be disclosed in writing, were well ahead of most OECD [Organisation for Economic Co-operation and Development] countries," Gupta says. "Notwithstanding this, there have been some persistent critics of the industry, calling for further regulatory reform." The industry would be better off continuing to be proactive in its own development rather than waiting for more legislation, Gupta suggests. "If its image is to be improved, one option is for it to reorganise itself as a profession comparable to other traditional professions, like law and accounting."

Gupta also sounds a cautionary note about excessive regulation, which can serve to create outcomes contrary to the policy intent. "Current disclosure requirements are so comprehensive and prescriptive, that the end-consumer may not understand the disclosures," he says. Further regulation, promoting a "tick-the-box" approach, might end up not advancing the cause for consumers.

Adoption of a fee-for-service rather than commission-based model for advice is preferable, Gupta argues. Development of the service-fee model was already underway, promoted by industry associations such as the funds management industry body, the Investment and Financial Services Association, and the Financial Planning Association, which represents financial planners. Fees and the need for greater efficiency are key issues being addressed in the Cooper superannuation review. Compared with the US, the fees charged by Australian superannuation funds remain high with no real evidence of the effects of economies of scale, Dunnin points out. The average superannuation fee in Australia is 1.25% and the average retail fee 2% to 2.5%. In the US, institutions are paying below 1%. "There has been a push here to lower fees. But as long as advice and insurance continue to be built in, it will be hard to get fees below 1%." The "commission ethos built in from top to bottom" also has to go, Gupta says.

Financial planners not operating on a fee-for-service basis are still paid a commission by the fund managers whose product they recommend to clients. "Fund managers have to develop a new relationship with planners where they are chosen because they have the best returns and the best product and not because they pay the highest commission," argues Dunnin.

Equally controversial to some is the current arrangement where investment managers receive a percentage of funds under management rather than a fixed-fee arrangement. Basically, a rise in the stockmarket of 20% automatically translates to a 20% lift in fees for the investment manager.

### Scrutinising Products

Also yet to come under scrutiny is the number and type of products that emerged in the lead up to the financial crisis, many of which failed to perform and several of which collapsed. The cynics attribute the constant marketing of new products to the big firms' eagerness not only to attract new funds but also to their desire to keep their name in lights. Collateralised debt obligations or CDOs – a form of credit derivative offering exposure to a large number of companies in a single instrument – were among the more popular products heavily promoted by many of the major global banks that fell from grace. Described by Hugh McLernon, managing director of litigation funding firm IMF (Australia), as "complicated gambling tickets", CDOs lured millions of investors with their promise of high returns.

While a few bad products emerged in the global financial crisis, Anthony Patterson, chief executive of

Perennial Investment Partners, says the industry as a whole should not have to take responsibility for one or two operators who have not done the right thing. The investment management industry, as distinct from funds management, is extremely competitive, he says. "There are 70 different investment houses that offer hundreds of products. Investors who purchase those assess them on their merit, and fees are a part of that. If you are unable, as an active investment manager, to deliver long-term, superior outcomes for clients on a net-of-fee basis, then you don't have a business." Patterson rejects the notion that the industry has a poor image. "Investors are well aware there have been a few issues that have surfaced through the financial crisis but, in the main, products and investment strategies have stood up for the long term," he says.

Warren Chant, principal of Chant West, agrees the industry ranked well as a performer through the financial crisis. Where it let itself down was with the "lousy" job it did in communicating the implications of the downturn to members. "The industry actually did a really good job in getting through the worst financial crisis since the last depression. None of the funds fell over, and there was only a handful of suspended redemptions or fund switching, but what they didn't do was communicate it well," says Chant.

A key reason the industry held up so well was the contribution levels from the compulsory superannuation levy, which "just keep chugging along", according to Chant. Fund managers should have been proactive in telling people what was happening, he says. "A large part of the industry had its head in the sand and didn't communicate appropriately. Members watch TV and could see what was happening but no one was telling them what it meant – other than to say they should focus on the long term. They didn't want to say what had happened in the short term."

US-based fund manager of Franklin Global Growth Coleen Barbeau says firms that didn't reach out to clients during the crisis or that deviated from their processes or style might either suffer from unhappy investors or have some explaining to do, but that neither would be a "lingering problem for the industry". Indeed, the significant turnaround in performance by global fund managers could see many of the pressing issues, such as fees and performance, once again fade in the distance – at least until the next downturn.

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