THE AGE
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INSIDE: MY SMALL BUSINESS

money

HOW TO MAKE AND ENJOY IT

Under review

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See through the fees

The government's shake-up of the financial services sector has widespread implications, writes Annette Sampson.

A comment by the former Woolworths chief executive, Roger Corbett, changed the life of financial planner, Daniel Brammell.

It was 2007 and Corbett, recently retired from Woolworths, was addressing the Financial Planning Association's 2007 conference.

Following his speech he asked to tell a story. Having recently retired and needing help with his own finances, he had been interviewing planners for several months. He wasn't impressed.

First, he said, minimum standards were too low. While some advisers were highly qualified and professional, levels of professionalism varied "dramatically" across the industry.

Second, he saw an "immense" conflict of interest in the way most planning practices were run.

"Your fee structure should allow you to be independent," said Corbett, now chairman of Fairfax Media, the publisher of *The Sydney Morning Herald*.

"I want an adviser who is proficient in their knowledge of his or her job and I'd be happy to pay but I want to know that the service is not qualified by any other source of income ...

"You can't purport to give financial advice to recommend a product and get commissions."

"The response was almost to boo him," Brammell says. "But it made perfect sense to me. Your ideal client comes along and tells you what to do and the response was to bag him. I didn't get it."

BUNFIGHT

More than three years on, most financial planners have come to accept (some grudgingly) that Corbett was right and commissions on investment products had to go.

The Financial Planning Association has also moved to address minimum standards.

But the huge bunfight going on over the government's Future of Financial Advice reforms shows old cultures die hard and conflicts of interest are alive and kicking.

The Assistant Treasurer, Bill Shorten, is expected to announce the final reforms to financial advice in the coming weeks with draft legislation to follow midyear.

Key proposals include a ban on commissions from 2012 (but only on new products – the lucrative flow of trail or ongoing commissions on existing investments will continue to grow), advisers having a fiduciary duty to put their clients' interests first and an opt-in requirement where investors will be asked each year if they're happy to continue paying their adviser.

To many investors it sounds like common sense but there are already murmurings that the reforms may be watered down following fierce lobbying from the big end of the financial services industry. In recent evidence before the Senate Economics Legislation Committee, Treasury officials said the opt-in requirement was still under consideration but could happen every three or five years rather than annually. They also signalled some volume-based rebates – payments to advisory firms that direct a lot of business to products like wrap accounts and other platforms – may be quarantined from the proposed ban on volume-based payments if they did not lead to conflicts of interest.

PASSIVE INCOME STREAM

Industry groups say it's all about keeping advice affordable for ordinary Australians by avoiding unnecessary rules and regulations; consumer groups and some independent advisers say it has more to do with maintaining the status quo and protecting the easy income that planners can earn.

For many investors it is all incomprehensible infighting. For them the issue is simple. As with Corbett, they want to be able to get professional, unconflicted advice. And for those without Corbett's earnings, they don't want to pay a fortune to get it.

A survey conducted last year by Investment Trends reveals a yawning gap between consumer expectations of financial advice and what the industry is delivering. It surveyed more than 1300 advisers and 1100 investors and found investors, on average, reckon visiting a financial planner should cost about $300 while the average planner says the break-even cost of providing full advice is $2700 and simple advice $1200.

An analyst for Investment Trends, Recep Peker, says the gap suggests many investors may be unaware of the true cost of advice under existing asset-based fee models where fees are automatically deducted from a client's investment. But the chairwoman of Choice, Jenni Mack, says the advice industry has not been delivering what the majority of consumers want.

"What we hear from consumers is that they want strategic advice and advice that is relevant to them at a particular point in their lives," Mack says. "But the drivers in the industry have all been towards full-scale holistic advice that provides a passive income stream for the industry."

Mack says many consumers don't want a full financial plan. They want targeted advice relevant to specific life events such as changing jobs and new superannuation arrangements, retiring, or setting mid-career financial goals. If they see an adviser, the advice is often to roll them out of existing assets and into products related to the adviser, which will generate income for him or her.

"What they have been offering is full-service, expensive advice but consumers want something different."

STRATEGIC ADVICE

Mack believes changing the drivers of the industry, the the reforms' intention, will make advisers more responsive to consumer needs. "One way things will change is that we'll see more advisers moving into strategic advice," she says.

"It will also be about finding low-cost ways of delivering what consumers want."

Brammell says Roger Corbett's comments led him to reappraise what he was offering clients.

He closed his existing practice and set up Brocktons Independent Advisory, which takes no commissions, has no links to product manufacturers and doesn't charge fees based on how much you have invested.

Brammell says part of Brocktons's offering is targeted advice for a flat fee of $440, though it also offers a more traditional comprehensive service for more sophisticated clients.

"You need to scale advice to be appropriate for the needs of the client," he says. "Someone can come in a say they need advice on X and it may be apparent that they need help in other areas as well.

"In that case you provide the advice they asked for but you can also recommend they look at getting help in other areas as well and outline what that will cost. The client is still in control."

Brammell says advisers often say that you can't make money charging these sorts of fees but "the truth is you can't make money charging the fees we do and not do anything for it".

The chief executive of the Financial Planning Association, Mark Rantall, says there is probably a misconception that the cost of advice for everyone is high but it comes back to the complexity of advice required.

> **'Passive commissions ... won't exist in a commission-free world.'**
>
> Mark Rantall, Financial Planning Association

Key points

Advice reforms:

- Commissions on new financial products to be banned from July 1, 2012.
- Advisers will also be required to act in clients' best interests.
- Volume-based payments will also be banned. Intensive lobbying may result in some payments, such as those from platforms to advisory groups, being quarantined. Consumer groups have pushed for a ban.
- Advisers will be able to charge asset-based fees despite arguments they are "commissions in disguise".
- Clients will be asked to renew advice arrangements annually. Industry lobbying may lead to this being watered down.

	TIME BASED FEES	FIXED FEES	ASSET BASED FEES	TRANSACTION FEES	PERFORMANCE FEES
	Usually charged as an hourly rate calculated in relation to the adviser's personal income.	Fixed dollar amount paid for a specific service, such as $3000 for full financial plan and $1500 for an annual review.	Clients are charged a percentage of the amount they have invested.	Less commonly used, these fees are charged for a particular transaction.	Generally charged as a percentage of profits above an agreed base level. Often operate in conjunction with asset-based fees.
PROS:	Widely used by other professionals. No bias towards recommending investments or products.	The client knows exactly what they're getting and the cost. No bias towards recommending investments or products.	Can be more cost-effective for smaller clients. Gives the adviser a vested interest in building your wealth.	You only pay when you use the service.	The adviser is only paid if you're making money.
CONS:	Often results in tension between adviser and client because of a sense "the clock is ticking". Can encourage overservicing.	Tensions can arise if the client wants extra services not covered by the base fee. Advisers may do the minimum work needed to justify their fee.	They are automatically deducted from your investment. Have no relationship to the amount of work done. Encourages adviser to recommend product to maximise fees.	There is a clear incentive to "churn" or switch clients between investments. Not conducive to ongoing relationships.	Can bias the adviser towards more risky investment strategies. Need to be carefully structured so that the adviser shares in any underperformance but can continue to service the client.

The abolition of commissions won't mean an end to complicated fee structures. The government decided to allow planners to decide how they charged for advice, resulting in a range of fee arrangements. Most, however, fall into one of five categories, although it is common for a mix of fees to be used.

He says simple advice is not necessarily expensive but there is a lack of understanding among many consumers of what financial advice is about that leads to them undervaluing it. "If you were to survey existing financial planning clients – and there's around 3 million of them that are active and around 5 million all up – you'd find they have a different perception [of what advice is worth]," he says.

OPT-IN RESISTANCE

However, the noise coming from the industry isn't about using this as an opportunity to create new business models that will appeal to a broader range of investors. It's about costs.

Almost half of the planners surveyed for the Investment Trends' 2010 *Planner Business Model Report* in October say they wouldn't be able to service clients with low account balances if commissions are banned. Sixty-one per cent intend to charge more for advice when the reforms are implemented and many intend to focus more on higher-net-worth clients.

The opt-in provision has them particularly perturbed.

Rantall says opt-in is an unnecessary burden that will increase costs to the industry by about $300 million. Treasury says the industry has estimated opt-in will cost about $100 a client or about $100,000 a year for an average-sized advisory firm with about 10,000 clients. The Association of Financial Advisers chief executive, Richard Klipin, says it will increase the price of advice and make it less accessable to "low value clients".

While it is good practice for advisers to see their clients every year and part of the FPA's professional code for its members, having a law requiring this to happen is "heavy-handed policy and inappropriate". "Opt-in is seeking to address passive commissions [commissions paid to advisers who are no longer earning them by servicing their clients] but these won't exist in a commission-free world," Rantall says.

"The government should also not be in a position to mandate the relationship between a professional and their client. It's unnecessary and overkill."

OLD REGIME HANDOVER

But Mack says such comments ignore the fact that the ban on commissions will only apply to new advice given. "Everyone who is already in a financial product [will] still be caught in the old regime," she says. "It doesn't deal with the $1.3 billion being paid in 2009 in commissions on super products alone." While opt-in would apply to existing clients, the commission ban will not. And while the details are still to be determined, the idea behind opt-in is that investors should be given the chance to renew (or not) their financial advice arrangements each year.

Rather than commissions (or asset-based fees) continuing indefinitely, opt-in would provide a prompt to rethink the arrangement and stop paying advice fees if clients aren't receiving value.

Many advisers already charging fees say the debate about opt-in is nonsense, as any half-decent adviser meets with clients at least once a year already.

"The people who are concerned are the ones who never see their clients," says the managing director of Sentinel Wealth, Justin Hooper. "But when you mention that to financial planners you get shouted down. My view is if you're delivering value for the income you receive, what's the

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See through fees

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problem?" Hooper says Sentinel already has client agreements that are reviewed annually. "I don't know what that costs specifically," he says

"It's just part of running the business and I don't know how else you would run the business. What profession doesn't have client agreements?"

Brammell says opt-in would also impose no extra costs on his business and that instead of focusing on the costs to planners who don't have ongoing contact with their clients, "someone should do a study on what it is costing clients at the moment who are not getting the service they're paying for".

VOLUME REBATES

Klipin says opt-in would increase costs for many of his members because their value proposition for clients may include ongoing contact through newsletters, seminars or email, rather than face-to-face meetings. In the pre-reform world, payment may have come from trail commissions but new clients will be asked to pay and will be able to walk away at any time

He says anyone who has received advice will have the mandatory statement of advice setting out fees and any commissions and all opt-in will achieve is to introduce more red tape.

Another contentious area is volume-based rebates, typically paid by investment platforms to their biggest customers. Mack is still optimistic the government will ban such rebates despite murmurings to the contrary.

"Consumers want strategic and specific advice but any form of volume-related bonus biases advice towards a product or platform," she says. "The trouble with any volume rebate is that they're very large, very difficult to disclose and have a major distorting effect on the advice given. They're particularly odious because they're just a very large hidden payment."

As Rantall puts it, not all volume rebates are the same.

"We support the ban on rebates at the product level and at the platform level where the rebate is going to the adviser [as opposed to the overarching advisory group] but we want to distinguish between platforms and product," he says.

"A platform is an administrative service that aggregates information [on investment products] and reports that information to the client. It's not an advice issue because it's about scale and rewarding efficiency gains."

Rantall says it is impossible for advisers to provide the full range of platforms to clients, as it would destroy any benefit from using the service because the adviser would have to deal with a host of reporting systems and any efficiency gains from using the service would be lost. Klipin says such rebates are "distribution margins" and a normal part of business if they go to the dealer group rather than individual advisers. With platforms operating differently, quarantining would be complex.

REFORM ESSENTIAL

Everyone seems to agree that the proposed reforms are essential for restoring confidence in financial planning after a string of investment product failures, the global financial crisis and much debate for and against commissions. Klipin says with only 20 per cent of Australians seeking advice, the government needs to address structural flaws and give consumers greater confidence to seek the advice they need

"Ensuring consumer trust, removing and dealing with conflicts of interest and making sure consumers are protected and have control are all something we support," Rantall says

Mack says the reforms are about getting rid of the conflicts that have damaged the quality of advice and caused very significant consumer detriment, while recognising the industry has a very useful and valid service to provide.

Insurance commissions encourage churning

The chairwoman of Choice, Jenni Mack, says when you buy life insurance, a commission of about 130 per cent of your first year's premium, then 10 per cent to 30 per cent each year after that, is paid to the sales agent who sold you the policy.

But the government is still to decide whether it will include life insurance in its ban on commissions paid to advisers. The industry argues that life insurance is not like super or investment products. It has traditionally been sold rather than bought, there is no investment asset that fees can be deducted from and, besides all that, Australians are chronically underinsured.

Consumer groups argue that commissions are commissions and if we're serious about ensuring financial planners act as professionals rather than sales people, they shouldn't be taking commissions.

If hefty commissions haven't solved the underinsurance problem, how is removing commissions, and thus reducing insurance premiums, going to make it worse?

Mack says leaving commissions intact would also create a "a flight to life", where advisers would flog more life insurance to boost their incomes. She says there has been a slight increase in sales following the GFC and talk of regulatory reform.

The managing director of Sentinel Wealth, Justin Hooper, says the sales culture in insurance is also alive and kicking. He says when conducting a recent session for financial advisers, they looked at a case study involving a law firm partner with a high income but few assets.

"He already had insurance but one guy said he would rewrite that insurance and generate $20,000 in commissions. That's just churning. You get even the best advisers reverting to that behaviour."