Wanted: financial advice that's truly independent

Clients are becoming more savvy and are questioning the payment of sales commissions, as are some in the industry itself.

Story Paddy Manning

For the past 15 years, Jim Stackpool has been helping financial planners wean themselves off sales commissions. His company, Strategic Consulting and Training, finds a growing market among a younger generation of advisers seeking to establish themselves as professionals rather than salespeople. Stackpool says these up-and-comers know the job of delivering financial advice will not be as easy for them as it was for their predecessors, the door-to-door life insurance reps who have been the mainstay of the industry and are nearing retirement.

Like Alan Swan, 62, the brother of federal Treasurer Wayne Swan, whose firm Swan Financial Services is aligned with MLC Financial Planning and earns most of its income from commissions.

In a recent interview Swan, who was careful not to speak on behalf of the government or his brother, made it clear he saw nothing wrong with commission-based remuneration and the intense focus on the issue was resulting in the overregulation of the industry.

For Swan, it doesn't matter much whether the fund manager or the client pays the planner. "What's the difference if you're getting the same amount of money?" he asks. "Does it matter who pays you? Whether the fund manager pays you or the client pays you?"

Stackpool says Swan's views would be typical of the majority of existing planners who "think they have already been put through enough pain" from the burst of new regulation over the past few years.

As Stackpool recently wrote for *Asset* magazine: "Most of our industry still has a long tail of inactive clients who are ignorantly paying a trail commission for what is essentially a commodity that was bought years ago. Inevitably, these inactive paying clients will come to understand the dollar amount (not weasel percentages) they are paying each year and, like expensive bad wine, they'll spit it out. Worse, potentially, they may even sue the adviser for appropriating their money. Rumour has it that litigation lawyers are looking for more work from our industry."

Stackpool says the new generation of planners is different. "They know intrinsically debate about commissions is only going to get hotter," he says. "Consumers are getting more educated, competition for the super dollar is going to get more intense and legislation is going to change."

Already the Minister for Superannuation and Corporate Law, Nick Sherry, has pledged to examine conflicts of interest in advisers' remuneration when he reviews the retail superannuation system.

According to research agency Rainmaker, there are about 18,000 financial planners earning fees of about $5 billion a year, paid out of $495 billion in funds under advice.

Most financial planners are agents of big fund managers, either as direct employees or as authorised representatives of a financial planning dealer group owned by a fund manager (see table).

While a range of fees and commissions is paid, one of the most controversial is the ongoing or "trail" commission, which is charged as a small percentage of the client's total funds and is deducted from their account by the fund manager and paid to the adviser – year-in, year-out, with no regard to the level of service provided.

Independent financial planner Brett Walker's FSI Consulting estimates that $500 million in such trail fees are paid each year that are "not linked to any service obligation at all". That's literally money for nothing.

Stackpool says the fund managers by and large have no interest in changing the fee system. "The product managers don't want to have to resell their product every year," he says.

He estimates it costs the big players between 0.05 and 0.1 of a percentage point of funds under management to run a wrap account – but they charge up to 0.5 of a percentage point for the service. That's a 500 per cent-plus mark-up.

Stackpool says there is an "untested" argument by financial planners that low-end consumers could not afford the advice if they paid it in advance, and prefer to pay via commissions. But this is increasingly being questioned.

The Reserve Bank of Australia's assistant governor financial markets, Ric Battellino, told the Australasian Finance and Banking Conference last December that consumers were under the spell of a "money illusion" about how they paid for advice. One problem is that clients bamboozled by percentage figures don't realise how much they are paying in annual fees. Another problem is that there is no correlation between the fee paid and the service.

Take a typical fee structure of a 2 per cent "upfront" fee, deducted from contributions, and an ongoing or "trail" commission of 0.5 per cent a year. Sounds small, but work it out in dollar figures.

Assume an investment of $100,000 plus annual contributions of $10,000 a year over 10 years. The initial fee of $2000 covers the planner's costs – for a face-to-face consultation, and for plan preparation. In the first year, the trail commission is just $535. By year 10, the balance has reached $345,296 but the trail commission has more than tripled to $1647 and is growing.

Yet by year 10 many clients are getting very little – if any – service from their adviser, says Stackpool. "What do you get for the $1647? A newsletter, a beef and bun party round Christmas, and a letter saying 'we're here for you, don't hesitate to call'. The service drops off, but there's no guarantee the fee drops off," he says.

Even when they do annual (or biannual) client reviews, Stackpool reckons most planners are not working that hard, "compared to the average hard-working doctor, or the average hard-working accountant".

Research agency Rainmaker estimates financial planners in Australia earn an average of roughly $280,000 per planner per year. This is likely to be skewed as there are very many salaried financial planners – so-called "tied agents", many working from a bank branch – who are earning $80,000-90,000 a year.

QInvest, the financial planning arm of QIC and QSuper, Queensland's public sector super scheme, has a different model. With 39 financial planners, 50,000 clients and about $6.5 billion in funds under advice, it charges its advisers out by the hour.

It charges from $55 for over-the-phone advice to $2000 for a full financial plan on transition to retirement, after a sit-down, 1.5-hour session with a planner. There is also a private client area for those with more than $1 million invested. There is no ongoing fee, no trail, no commission. Salaried planners receive incentive payments, but they are not linked to the volume of funds under advice. Incentives are structured around service: evidence of complaints, client satisfaction surveys and appraisals where management sits in on client interviews. Remuneration is in line with the industry average for salaried agents.

QInvest chief executive Bill Danaher, a former executive with CBA, concedes the remuneration model might be less attractive for the more entrepreneurial adviser.

But that suits QInvest – which Danaher says has "very much a client-centred ethos" – just fine. QInvest recently won a tender to provide the same service to First State Super, the NSW public sector scheme, which is the biggest fund in Australia.

The model is completely scalable and one path to the future of advice, according to Stackpool, who consults to QInvest. This is bound to catch the eye of the corporate regulator, which is concerned about the undersupply of planners.

There are other models.

Take Daniel Brammall, a Canberra representative of privately owned Australian Independent Financial Advisers, which also has offices in Perth and Melbourne.

AIFA is not owned by a fund manager and does not receive commissions from fund managers. AIFA planners charge a retainer, which is not calculated as a percentage of the amount a client has to invest. Brammall says disclosing a commission does not cure the adviser's conflict of interest, because the client is not told what the fees are on comparable products. The disclosure is useless information.

As Brammall wrote in a recent AIFA newsletter, imagine an adviser is weighing up two products: "Product X might not be bad, per se, but what if ABC product (that pays no commission) is superior? In this instance the planner is making a judgement he's not entitled to make: Product X isn't the best available but it'll do a good enough job plus I still get paid. Let me ask you this, though: if he were advising his mum would she waltz out of his office clutching the superior ABC or instead the second-rate, commission-laden X?"

Brammall also says percentage-based fees predispose the adviser towards investing in managed funds.

"But what if the best advice, after someone receives a $1 million inheritance, is to pay off debt. The remuneration structure needs to be conflict-free."

He adds there is no necessary link between the level of advice provided and the amount of money invested: "It's a mistake to expect it takes me twice as long to manage $500,000 as it does to manage $250,000."

Looking for conflict . . . Nick Sherry is reviewing retail super. Photo Nic Walker

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Plans for you

Ownership of the top 10 financial planning dealer groups

Adviser Group Name	Owned by	Advisers	Funds under advice ($m)
Professional Investment Services Pty Ltd	Privately owned*	1486	18,200
AMP Financial Planning Pty Ltd	AMP group	1296	43,675
Count Wealth Accountants	Listed	900	7,400
Commonwealth Financial Planning	CommBank	704	25,883
Westpac Financial Planning	Westpac Bank	594	24,147
Millennium 3 Financial Services Pty Ltd	ING Australia	517	4,200
National Australia Financial Planning	NAB	465	11,325
Charter Financial Planning	AXA Australia	447	2,640
ABN Amro Morgans	ABN Amro	447	30,000
SECURITOR Financial Group	St George	443	15,000

Figures as at December 2007 * Insurer Aviva owns 25% of PIS SOURCE: WWW.RAINMAKER.COM.AU