

The great commission debate.

An opinion from Jason Bragger, principal of Dolfinwise; a genuine fee for service business

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A concise history:

The financial planning “profession” grew out of the life insurance industry which had a long history of sales practices around product. Agents were generally tied to one company’s products for commissions. During the 1980’s and early 1990’s many agents started to sell investment products along side the traditional life policies. and continued to be paid by product . A, As a general rule sales people did not claim to be other than representatives of the product provider.

During the 1990’s the concept of a “financial planner” or “financial adviser” started to gain prominence and some of the previous Insurance agents started to expand their offer to include selling products for more than one company.

In 2001 introduction of the Financial Services reform bill resulted in all sales people and planners becoming categorized under the single heading of planner or adviser. This made most financial product sales people “authorised representatives” of an Australian Financial Services Licensee. These licensees based on history were almost all owned by financial product providers and provided their licensed “advisers” with numerous incentives to recommend their own products. Nearly all authorised representatives dealing with investment products started to use the term financial adviser or financial planner whether or not this was a reasonable description of the service they were providing to their client.

This history created a a flawed industry where product providers pay, incentivise, train and encourage their “authorised representatives” to sell their products while presenting themselves to the market as “advisers”. Consumers needing advice have in the past gone to product sales people thinking they were accessing impartial advice ..

The present

While most advisers argue they do provide great benefit to their clients through their advice, the advice is generally filtered through a screening process which puts the product in front of strategy or general advice. this is a flawed process based on each client’s individual needs.

There is also a fundamental conflict of interest between what the client may require and the mechanism by which the “financial adviser” earns their living.

Despite legislation requiring full disclosure of these conflicts the complexity of financial issues and the industry is so great many clients simply do not understand that the “advice” they are getting may not be in their absolute best interests.

Obvious examples of the impact of these conflicts of interest are as follows:

If we think about it, few commission based advisers will consider recommending clients pay down their home loans, cash in managed funds to buy term deposits, buy investment properties, buy direct shares, or retain or use industry superannuation funds when these are all solid strategy options that are appropriate for many clients.

Client benefits of a pure fee for service business model:

Clients of pure fee for service advisers can be assured that the adviser is attempting to provide advice to a client that is in the clients “best” interests. As opposed to most authorised representatives who currently attempt to improve the client’s situation in some way while justifying a product sale thereby not necessarily creating the optimum solution for the client.

Dolfinwise believe that those professing to be “financial advisers” or “financial planners” should be obliged to provide to the best of their skills and knowledge the “best possible advice for the individual client based on their disclosed circumstances.

It is arguable in this situation, whether product providers would derive any benefit from licensing this type of adviser.. “Advisers are increasingly likely to operate on a fixed (hourly, monthly or annual retainer). Once the fixed rate or fee is agreed with the client then method of payment can be chosen based on convenience, tax efficiency or other.

We feel the fee should not be asset linked as this can create a bias towards the adviser increasing investment exposure and possibly encouraging excess risk taking in the portfolio.

At Dolfinwise we have noted the governments interest in the industry’s conflict levels and while we believe there is still a place for wrap accounts, managed funds, and life insurance we do consider them to be product and we envisage the regulator redefining the word adviser or planner. We foreshadow sales agents attached to products not being allowed to call themselves “advisers”.

Trying to create one playing field for all authorised representatives is likely to cause clients to be limited for choice with some unintended negative consequences. Many current “authorised representatives” do not have the technical skills or knowledge to become advisers that would be able to charge sufficient for their advice to cover the cost of running a practice in the current regulatory regime.

We believe strongly however that the current regime needs changing so clients are not guided by sales people presenting themselves as financial advisers but being driven by sales targets and the need to place funds in commission based products.

The government could help with the suggested transition above by reducing the onerous compliance burden on practices imposed by the FSRA.

We note that if genuine financial advice practices as described above are free from conflict of interest many of the protections and documentation required under FSR in giving advice could in fact be reduced

Our expected outcomes:

It is likely that upfront commissions and inbuilt trailing commission will be banned. This is a very small step in the right direction but not a major shift. While advisers will have to disclose to a client what their upfront cost will be, a large part of the industry already does this and many who don't, if forced will be able to make this adaption with some coaching.

There is also growing momentum for asset based charging to be eliminated however it would be a significant issue for the industry if this were to happen as advisers would be required to negotiate a specific fee with each client they engaged. As mentioned above, many will simply not have the expertise or experience to convince clients of their value proposition.

Our preferred solution is that all who claim to be "financial planners" moving forward should be required to agree a fixed fee for both the upfront and ongoing work with their clients.

Additional sales bonuses that are currently paid to licensees by product providers to encourage loyalty also distort the market and may encourage advisers to recommend products that may not be in the client's best interests. They also create a layer of fat added to the product fees that client's pay and fund amongst other things, overseas junkets and excessive hospitality to encourage advisers and advice networks to stay loyal to a product regardless of its relative merits for the client.

In our view these payments should be phased out over a set period of time to allow licensees to adjust but ultimately force products to compete for adviser attention based solely on their attributes.

While a number of industry commentators have suggested a dual licensing system as I have advocated above, there does not appear to be great momentum for this view at this point in time. This has been attempted in the UK but without great success.

Whatever the outcome of the various current regulatory reviews, we hope the industry is given reasonable timeframes to adapt to the changes. Having said this, we hope client outcomes are ultimately put above the lobby groups vested interest in maintaining their product sales at all costs. Disclaimer - For the record, due to historical practices the author's business still receives a small amount of trailing investment commissions. Dolphinwise does however rebate any volume bonuses he receives to clients who have agreed to pay an annual fee for service.

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For more information on Dolphinwise's fee for service advice model visit www.dolphinwise.com.au