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Time to act: fee deadline looms

IFA Cover Story

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A little over a year ago the FPA made the commitment for all of its members to be remunerated on a fee-for-service basis from 1 July 2012. While this was a positive step for the financial planning industry and the wider financial services community, it really only applied to FPA members.

However, in April this year Financial Services Minister Chris Bowen declared the government's intention to enforce a move away from commissions to fee-for-service remuneration arrangements by law.

This meant all financial services participants now had to address the issue, not just FPA members.

The government's time frame for outlawing commissions coincided with the FPA's, giving the industry just over two years to fall into line.

Already some interesting thoughts and attitudes are beginning to emerge from the financial planning sector as to how advisers will cope with the changes.

Investment Trends research released earlier this month showed a large number of advisers thought the process of transitioning to the new remuneration framework would result in some of their peers leaving the industry.

Specifically, of the 472 planners surveyed 57 per cent thought some planners would finish up, while 28 per cent thought many planners would end up leaving.

Interestingly, few participants thought it would be themselves that would be part of the leaving group.

The only thing that could drive a planner exodus is the tasks they are required to perform by their dealer groups to comply with the new remuneration regime.

So what are some of the dealer groups doing and will it be enough to bed everything down in time? And what are some of the other parts of the industry going through?

Financial planning

The debate over commissions versus fees has raged for a good number of decades and the fact the discussion would not go away prompted some dealer groups to make provisions for a change in remuneration structures before any of the announcements about the future direction of the industry were made.

For example, the Axa Financial Advice Network's Future Ready program, which is helping its authorised representatives make the switch, had its origins several years ago. The Axa Financial Advice Network includes the Charter and Axa Financial Planning dealer groups.

"Really we've been gearing up for this eventuality over the last four years, even though we may not have known what that eventuality was. The program began in earnest around September and October last year when the state of play was starting to become more concrete," Axa Financial Advice Network business and marketing programs national manager Sam Aylett says.

Like Axa, AMP Financial Planning (AMPFP) also anticipated having to implement a new remuneration model for its advisers at some point before any firm parameters were handed down.

"We'd been thinking about this and had this on our minds for a little while, so we've probably had more time to prepare than others. We've understood where the market was going to go and probably predicted what would happen, so we moved on it quite early towards the end of last year," AMP financial planning and advice director Steve Helmich says.

RI Advice Group was in a similar situation and developed a fee-for-advice model a few years ago to assist advisers who wanted to adopt this method back then. With this experience under its belt, RI Advice started rolling out a fee-for-service model last year to comply with the future remuneration framework, according to RI Advice Group chief executive Paul Campbell.

How to arrive at an appropriate fee has been the crux of a lot of the activities dealer groups have been undertaking with their authorised representatives.

Not surprisingly, dealer groups have rejected the notion that the new fee regime will merely be just a substitute for the commissions currently being received, choosing instead to use the opportunity to strip practices back to their most fundamental operational level and formulating an appropriate fee from there.

"In terms of the actual price, we look at a number of different aspects. First there's the commercial aspect, which is getting an understanding of the actual direct costs incurred. That's based on staff or labour costs and any other direct costs," Aylett says.

"What gets a little more difficult is how you establish the indirect costs, the actual

costs of running the practice, and how to fairly apportion these costs into the price of advice. We have a methodology of doing that based on activity-based costing. Then we come up with what we call a retail price once we've considered the appropriate profit margin for the practice."

The dealer group also takes into account the value of the advice to the client in the process.

RI Advice has applied a similar philosophy in working with its financial planning network.

"We've got a process that actually analyses all their underlying costs and reviews their processes and the advice model. It helps them understand how much it costs to provide advice and therefore what kind of fee structures they should come up with," Campbell says.

"They'll come up with a range of fee options, depending on what the client wants from the point of view of different service offerings."

The cost of servicing a client has also been a critical element for AMPFP's transition to fee-for-service program.

"It's been about getting to understand what their cost to serve is. That's where the fee comes in because if you understand the cost to serve in your practice from the low-end to the high-touch clients, it will allow you to set the appropriate fee," Helmich says.

One of the main concerns about the switch to fee-for-service has been a potential resultant increase in the cost of financial advice for consumers.

While this may have been true in some instances, Helmich believes it is more about accurately pricing the advice received rather than about the actual dollar amount arrived at.

"I don't know if it will lead to more expensive advice. What I think will happen is that the clients will get a better understanding of what they are paying for and the challenge is to make sure it's valued by the client because if they don't value it, they've got the right to turn it off," he says.

And the change in pricing may not mean financial advice will be more expensive.

"It doesn't necessarily mean that all prices go up. Some prices can come down, depending on the client services arrangement," Charter and Axa Financial Planning national manager Paul Williams says.

Because the process for most dealer groups is still being performed, gauging client reaction to being charged on a fee-for-service basis has been difficult. However, some anecdotal evidence has surfaced.

Godfrey Pembroke, which switched to a fee-for-service model back in 2006, has

received only positive feedback since it made the move.

"In the client seminars that I go to I've only ever received positive comments from clients about our fee-for-advice stance. And I've never had a negative story from an adviser in all that time when they were dealing with their clients," Godfrey Pembroke general manager Tom Reddacliff says.

From an adviser viewpoint, the transition to a new remuneration scheme and the process that goes with it have in some cases led to forming a more profitable practice.

"Even with the effects of the global financial crisis, the practices that are re-engineering their client value propositions we are seeing experience about a 12 per cent differential in their profitability. So we would be seeing these practices having a 12 per cent uplift in revenue and profitability by re-engineering their practices along these lines," Aylett says.

While the processes to comply with the new regulations are all underway, the one question that remains is will all of the dealer groups' practices be ready in time for the 1 July 2012 deadline?

Campbell says he has no doubt this will be the case.

"The vast majority of our network is on that journey. They're either there or part way there, so we're in a really good position and the network as a whole is quite comfortable with the idea of moving to fee-for-advice," he says.

Axa and AMPFP are even more confident of completing their changes well before the deadline looms.

"We'll be ready to go by 1 July this year," Aylett declares.

And AMPFP is looking at a similar time frame for reaching the end of its process.

"At this stage I'm feeling really confident. It's one of the best change programs managed at AMP in the last five years and by the time 1 July comes around, we're going two years before everyone else, we'll be there," Helmich says.

The product space

The industry's move to fee-for-service-based remuneration structures will definitely not be achieved in isolation, with product manufacturers and platform providers also set to play a key role.

In contrast to the openness most financial planning dealer groups are showing with their moves to fall into line with the proposed legislation, it would appear a more cautious approach is being employed in this arena with most participants in

the space wanting to study the fine print of the legislation before making a call on how the situation will play out.

To this end, all platform providers contacted by IFA were unwilling to comment on the current state of affairs.

While still looking at the situation from a dealer group perspective, the predicament of the product was possibly summed up by Campbell.

"A lot of the things as far as products go all depends on how the legislation plays out. There is a lot of devil in the detail and I don't think there is any point speculating on any of that yet because we don't know exactly what is going to happen," he says.

However, even though they may not be willing to discuss what they are doing as a matter of public record, all of them are preparing for the new financial services landscape in some way.

For example, some discussions between dealer groups and platform providers have already taken place on the subject.

"We're pretty strongly associated with Asgard, we've also got links to BT and the MLC platform and we've been in heavy discussions with all of them about the future and what we want from them and how we want it presented, that is, the term commission has got to go from 1 July and shouldn't be represented in PDSs (product disclosure statements), because basically it will be a fee negotiated between the planner and the client," Helmich says.

"So we've had some pretty strong discussions in that space and we've said to them 'if you are going to be a week or two late and you can't get it done let us know'. To their credit they've all come to the party."

The various dealer groups are not only examining what their platform providers are doing in response to the Future of Financial Advice reforms, but also assessing the products currently included on their approved product lists (APL).

And opinions at the moment are mixed as to the outcomes that might be expected from this review.

"With Charter Financial Planning and the approved product list there, we're making sure that we have a very good understanding that the products that are available on there where appropriate and where possible are making the shift according to the IFSA (Investment and Financial Services Association) guidelines," Aylett says.

"We don't anticipate any huge changes in our APL at all."

AMPFP on the other hand expects some products will not meet the new criteria.

"We called all the external product providers in last August and told them what

we were doing then because we wanted them to have plenty of time to prepare as it would be unfair to drop it on them at short notice. To their credit most of them have done what they've needed to do," Helmich says.

"We have had to make a few changes because there were a couple who couldn't get there that have been put on hold or excluded from the list.

"But they're not major products we use so we don't see much disruption from that."

Because Godfrey Pembroke has had more time operating under the fee-for-service regime, it has also had more time to shape its APL appropriately and more changes are being forecast.

"We're obviously moving even more strongly in the fee-for-advice direction, so my preferred option is to have products on the APL where you don't have to rebate commissions back. So I can only see us putting a stronger lens on our approved product list around compatibility with fee-for-advice," Reddacliff says.

So what type of products might suffer in the process and might not fit into the new remuneration framework?

Russell Investments retail managing director Patricia Curtin feels one group can be identified readily.

"Old legacy products I think will come under scrutiny and will struggle to retain their clients within. As clients become much more aware of fee-for-service and less of the bundled options, they may approach their planner for the new-age product," Curtin says.

However, with dealer groups driving the forces of change, Curtin intimates the process may lead to a change in operation of these organisations.

"Dealer groups themselves are asking the question of their role in product management and development and whether they should take a more active role in this," she says.

"They would do this as it would give them a better way to understand their network requirements in identifying the appropriate platform that meets the needs of their network and then the appropriate product that goes on that platform."

If this development did take place, it could lead to a situation where advisers once again turned their focus back toward in-house offerings as opposed to external ones.

However, the dealer groups were adamant this type of focus would not result from the process underway.

"We don't expect a shift to in-house products. In fact, we're not anticipating a

shift in either direction," Aylett says.

Campbell echoed this sentiment.

"From my perspective I don't see that happening. Our advisers are independently owned, they run their own practices and they choose the products in the best interest of the client," he says.

Risk insurance

Both the FPA and Bowen have shared the same approach toward risk insurance in regard to the change in remuneration structures for financial advisers.

They have agreed to leave risk insurance out of the initial move to ban commissions, with a view to conducting further discussions with the industry to find out what the best remuneration structure for these types of products should be.

Not wanting to wait until the last minute, discussions are already taking place about how the risk insurance sector might be ultimately affected by this initiative.

"Certainly there has been a lot of discussion and debate within Tower as to how this might unfold," Tower Australia chief executive of retail Brett Clark says.

These discussions have involved going right back to understanding the structural differences between an investment product and a risk product.

"Before we charge down a path related to policy of fees versus commissions, we need to understand what the implications of adopting a fees or commissions basis is, acknowledging those commissions in product structures," Clark says.

And even if the insurers themselves had wanted to sit on their hands to passively see how things would play out, it would appear they may not have been allowed to by the adviser community.

"We spoke to a group of advisers recently about this very issue," Clark says.

And perhaps a change to a pure fee-for-service basis may not be that dramatic anyway, he says.

"The point I would make there is that our product already allows for flexibility in remuneration structures between advisers and their customers. The charging mechanisms within the product allow for the advisers to operate on a fee-for-service basis or a commission basis and the product will respond accordingly," he says.

As mentioned previously, Godfrey Pembroke began the process of implementing a pure fee-for-service remuneration structure back in 2006, which has arguably

allowed it to address additional issues in the move. Recently Godfrey Pembroke began examining the risk insurance space and how it could bring those products into line with its existing remuneration philosophy.

"We've given a commitment that we are going to implement a complete fee model, so we're definitely having a look at insurance," Reddacliff says.

To that end, Godfrey Pembroke is in the process of implementing a 10-point plan to address the issue akin to the process it undertook with its original remuneration restructure.

"What we're doing is really scoping out what the value of risk advice is to the client, what we are trying to achieve, what the engagement process is, and putting together different scenarios and different advice models," Reddacliff says.

"We're also in discussions with product providers because we obviously want to make sure the client gets the best possible deal with the product providers we use."

In contrast, other dealer groups such as RI Advice and AMPFP have left the insurance debate well alone for the time being.

"We haven't spent any time trying to understand how the insurance model will work because at the moment it is what it is," Campbell says.

Helmich was in much the same position as AMP has had its focus on financial planning and superannuation.

"We'll watch the discussion and the debate. It is a different issue, but we're very aware of the need be contemporary and make sure we do what we've got to do, but the key issue is that the commission on an insurance policy doesn't come out of the asset of the client," he says.

"There is an argument for both ways on insurance and I suppose at the moment we're neutral because we want to see where the market is going to go and see what the industry is going to do."

Further industry consultation in the risk insurance space has still got to take place, but Clark can see the outcome being a compulsory move to ban commissions for these products too if a strong enough case is not put forward to maintain the status quo. He says that case has to be presented now.

"I think what minister Bowen is saying to the industry is make the case. I think he is saying he acknowledges there are differences in product structures but wants the case made to him as to why we should be carving out insurance, and that's a challenge to the industry and an appropriate one," he says.

To take the sting and relevance out of this discussion, some sector participants have been suggesting that risk insurance be looked upon as general insurance rather than being lumped together with other uncorrelated financial services

products.

"It's very clear in my mind that life insurance as a product concept is far more aligned to other insurance products in the market, be it general insurance or health insurance products, and we're not having the debate around those. We're having the debate around life insurance because of its distribution channels and the regulatory environment," Clark says.

"A lot of people are saying look at the underlying product structures and acknowledge we shouldn't necessarily be making these changes for policy sake."

However, should risk insurance be treated like other insurance products, would this have other consequences for financial planners in regard to finding a different distribution channel for these products? Clark denies this would be the case.

"Many advice businesses in a wider sense actually provide advice and support around some of these other products, such as general insurance and mortgage products. So let's not kid ourselves a customer will walk into an adviser's office and all they'll ever see is a financial services product being provided under a fee-for-service or any other regulatory environment," he says.

"As such, we shouldn't be concerned that we may have a different charging mechanism for investment products versus life risk."

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