

Tangled web of asset-based fees

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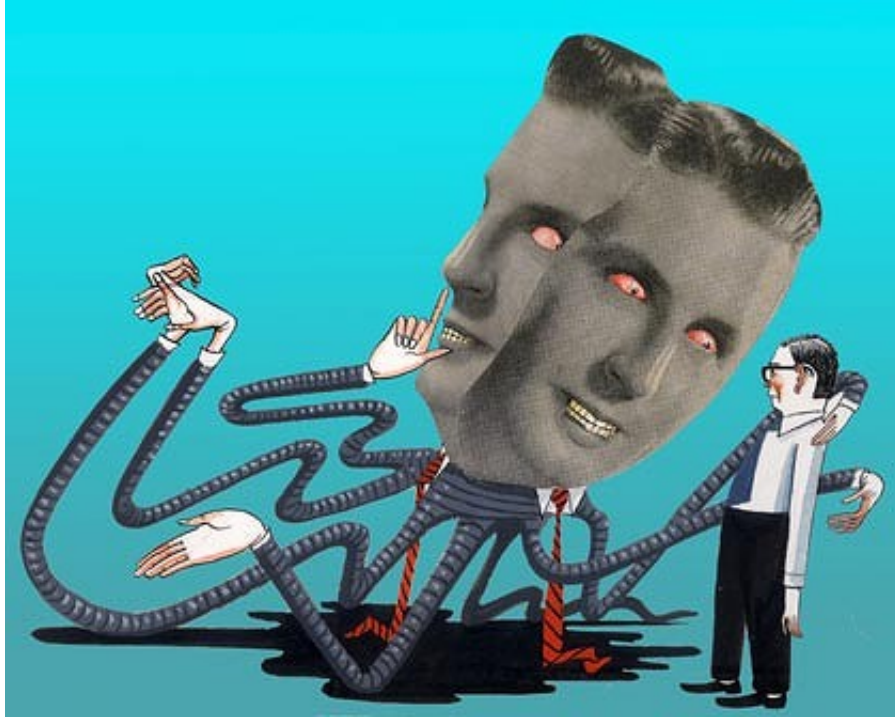


Illustration: Simon Letch.

Not all experts are convinced reforms to financial advice will work. Annette Sampson reports.

The promise is a brave new world with no commissions in it. A world where consumers who need financial advice know their chosen adviser has only their interests at heart. A world where products are recommended on their merits, rather than based on who owns them or how much they pay in kickbacks; where selling products is secondary anyway, with the real emphasis on strategic advice to protect and build wealth.

But this rosy picture of the government's proposed reforms to financial advice may be difficult, if not impossible, to achieve.

Parts of the financial services industry are lobbying to water down elements of the reforms to protect the relationship between financial advisers and companies offering financial products.

Critics argue the reforms will put good advisers out of business and make advice unaffordable for all but high-net-worth investors. Others argue that the reforms don't go nearly far enough; and with the advice and financial product industries so firmly intertwined, conflicts of interest remain inevitable.

THE REFORMS

The reforms revolve around three key measures:

- * A ban on commissions and other volume-based incentives from July 1, 2012 - though this won't apply to existing investments.
- * A legislated fiduciary duty to put the client's interests first.
- * And an annual "opt-in" arrangement where advisers will be required to request that clients renew their arrangements each year.

The Financial Services Minister, Chris Bowen, told the Parliament in Canberra last month that the reforms were intended to "address the conflicts of interest that have coloured the perception - and sometimes the reality - of the quality of financial advice provided to Australian investors".

"If financial advice is to be an important part of investment decision-making in this country ... then it must abide by a fundamental ethical principle," he said. "That principle is that the financial advice given to Australian investors should be in their best interests."

Bowen said the reforms also included measures to allow simple, affordable advice, improve investor protection and increase professionalism. The simple "intra-fund" advice super funds are allowed to provide will be

extended to cover a broader range of topics. Bowen said the government was looking at whether this could be extended to groups such as financial planners.

The Australian Securities and Investments Commission's powers to act against unscrupulous operators will be enhanced, professional standards for advisers reviewed by an expert advisory panel, the classification of sophisticated investors reviewed and introduction of a statutory compensation scheme examined by an expert in corporate law.

The exemption from licensing for accountants will also be removed and replaced with something considered more appropriate.

THE POSITIVES

The acting chief executive of the Financial Planning Association, Deen Sanders, says the sleeper for investors is the government's intention to expand access to financial advice. If extended beyond super funds, Sanders says removing the barriers to simple, affordable advice would be a huge benefit to the majority of Australians who don't currently consult a financial planner.

He says it would also help fill the gap left by abolishing commissions. "Arguably a lot of people have been getting very good advice quite cheaply due to commissions," he says. "But we need to make sure they're getting truthful pricing. Advice can be simpler and cheaper but one of the problems now is that consumers can't tell where they're getting advice from - professional planners or single-issue-product floggers."

Sanders says many planners support the reforms, recognising the need to build trust in the industry, particularly after the high-profile collapse of groups such as Storm Financial. He says hundreds of planners have been fronting up at Treasury's public information sessions and while there are always one or two who get up and curse the government, they're in the minority.

"When [the FPA] started the conversation on [reforming] remuneration two years ago we were told we'd be killed in our sleep," he says.

"But while it has been a tough dialogue, 65 per cent of planners agreed with [abolishing commissions] and 85 per cent of certified financial planners agreed."

The chief executive of the Association of Financial Advisers, Richard Klipin, hopes the reforms will boost the number of people seeking financial advice from current levels of about 30 per cent. He says while most good advisers already act in their clients' best interests, defining their fiduciary responsibility in legislation is an important step.

He says all the focus on commissions "misses the real point" - that clients pay for strategic direction. Product fees, he says, would have to apply somewhere but should not be the main focus.

By banning commissions in favour of more transparent payments from clients to advisers, the government is hoping to put the emphasis back where it should be - on the quality of advice given.

Groups such as MLC and AMP have already moved to phase out commissions and the FPA believes, with 85 per cent of its members already having some sort of fee for service in place, most planners will be well prepared for the 2012 changes.

The principal of Investment Trends, Mark Johnston, says abolishing commissions is also likely to accelerate the move to advisers recommending a broader range of investments.

"Planners have been saying they will increase their use of direct equities, index products and things like exchange-traded funds," he says. "The proportion of money going into direct equities especially has been

growing at the expense of managed funds. The proportion of money going into managed funds is still a bit over half but it was 75 per cent about five years ago."

While this is tied in with the move by planners to fee-for-service (which removes the bias towards commission-paying funds), Johnston says it has also been driven by a "lingering investor backlash" towards the managed funds industry following the global financial crisis and the growing popularity of online trading and ETFs.

SHORTCOMINGS

But banning commissions won't address all the conflicts of interest. With the majority of financial planning groups owned by larger financial institutions, and \$8 of every \$10 invested by planners going through platforms owned by these institutions, some say commissions are merely the tip of the conflict iceberg.

"As long as fund managers are allowed to control financial planners and planners can charge a percentage fee for their services, the conflicts will remain," says a director at Strategy Financial Consulting, Glen Killen. A former National Australia Bank adviser, Killen says he is particularly annoyed by some institutions replacing, say, an existing 0.66 per cent commission with a 1.1 per cent fee.

"Abolishing commissions is a nothing step because most advisers have cottoned on to the fact that they can increase their revenue by 60 or 70 per cent while telling clients they're getting a better deal."

Killen reckons such asset-based fees are "commissions by another name", as they are unrelated to the work actually performed by the planner.

Johnston says asset-based fees are the big growth area in planner remuneration. Revenue from such fees has grown by 60 per cent since 2006, while there has been only modest growth in fixed fees or hourly rates.

For his part, Deen Sanders says he is "baffled" why asset-based fees are contentious. "As the architect of fee for service within the FPA, I looked at fee structures in terms of accountability and transparency. We say it doesn't matter what the assets are but planners can't charge inappropriate fees."

The managing director of Strategy First Financial Planning, David Price, says while the reforms are a big step forward, they don't address issues such as the difference between financial and product advice. "Historically, most advisers have given product advice on investments, super and insurance," he says. "A lot of people will go to an AMP adviser and are happy to buy AMP products because it's a big, secure institution. I don't have a problem with that but I do have a problem when advisers pretend to offer something different. They pretend to offer strategic advice when it's all about product."

Price and Killen are also both critical of the government's decision to exclude insurance products from the commission ban. "A lot of insurance companies are paying 30 per cent commissions," Killen says. "We have a massive underinsurance problem but a lot of people don't buy enough insurance because of the cost. If you could knock even 20 per cent off the cost [by abolishing the commission], a lot more could afford it."

The Cooper Review this week recommended commissions be banned on insurance offered through super funds.

OWNERSHIP AND PLATFORMS

It is the ownership and distribution ties between financial institutions and platforms that can create the trickiest conflicts. Price says the system was not intentionally set up that way but Choice was correct in 2002 when it said the industry was structurally corrupt. "It's an issue that no one knows how to address," he says.

Indeed, Sanders says the ideal of a fully independent planner is rare. "Consumer perceptions of the links between planners and financial institutions is a real concern and in many ways those concerns are truthfully

founded," he says. "The best option currently available is the idea of absolutely ensuring the planner has [their clients'] interests at heart over and above their business model.

"The UK attempted [to come up with a definition] and its version of independence will mean that so long as an adviser has some sort of independent research process, it can call itself independent. That's not even a figment of independence."

The close interweaving of planners and financial institutions is probably best seen in the use of platforms - administrative structures through which planners invest their clients' money.

Significantly, Johnston says, while the mix of underlying investments used by planners is changing, what isn't changing is their use of platforms.

The managing director of Wealth Insights, Vanessa McMahon, says the platform market has undergone "massive consolidation" in recent years and is now dominated by about eight groups. These include the big names such as Westpac/BT, Commonwealth Bank/Colonial Financial Services, NAB/MLC, IOOF, ANZ, Macquarie, AXA, Perpetual and AMP. If AXA is taken over by NAB or AMP, ownership is likely to be further concentrated.

These institutions also own planning networks that are either required or encouraged to use the in-house platform.

"That's why there's been so much focus by the banks on buying companies with platforms," says the managing director of Plan for Life, Simon Solomon. "It's all about distribution."

Along with commissions or adviser service fees, platforms also commonly pay volume bonuses to planning groups that direct a lot of business their way. Unlike commissions, which are paid to the individual adviser group, these bonuses are paid to the dealer group, which may, or may not, pass on part to the adviser. Price says advisers may not even be aware that the bonus is being paid, or how much it is worth, which means it is often not disclosed to clients.

Strategy First does not take volume bonuses from platforms and has instead negotiated cheaper rates for its clients, but more commonly the bonus is soaked up by the planning group or adviser.

It's big business and so it comes as no surprise that platform providers have been actively lobbying the government for an exemption to its ban on volume bonuses and similar payments.

They argue that platforms are a service, not a financial product.

Sanders says while some platform operators are "fairly confident" they will be exempted from the ban on volume bonuses, that's not the FPA's view.

"Our view is any payment that encourages volume sales is inherently banned. I can't see how platform providers could have an alternative view," he says.

"We have real concerns about anything that influences or biases the advice a client receives."

However, Solomon says there are so many charges levied in platforms that it will be difficult to determine whether volume bonuses have been abolished or transformed into something else.

If volume bonuses were stopped, they could simply create another fee such as a marketing allowance so the dealer can run its business and generate more business for the platform."

Killen says his fee-for-service practice uses a cheaper administration service provided online by Praemium, but

it can do this only because the licensee is genuinely independent: "If you're owned by a fund manager or platform provider you'll never have that freedom. These groups want to be the gatekeepers. It's not important which products you ultimately invest in but the platform you go through."

INDUSTRY CONCERNS

While they are broadly supportive of the government reforms, the financial planning groups say they are concerned with the detail of how such features as the opt-in requirement and fiduciary duty will work.

Sanders says the Coalition has also indicated it will overturn many of the proposals if it wins government. "That's obviously not something we support but it's what they have indicated."

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