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Fee-for-service: Advice industry gets a wake- up call

IFA Cover Story

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In fewer than two years, most advice-related commissions will be banned for good, forbidden by law to perform their traditional heavy lifting of the industry's revenue line.

Instead, Australia's 16,000 planners will be required to adopt a fee-for-service payment system, a transition many have already embarked upon and a few have even embraced.

Critics say the ban on commissions is government interference in a system that has worked for decades to the advantage of advisers and their clients.

Others, however, say it's an opportunity - financial advisers' chance to shed their reputation as sales agents and for the industry to take its place as a true profession alongside law, accounting and even medicine.

It's a wake-up call and if the industry's response is active, effective and sincere, the prize is the Holy Grail of professionals the world over: respect.

But what's at risk? The biggest risk is to the industry's very foundation if it fails to effectively embrace this change and successfully shift to a fee-for-service model, industry participants say.

Strategic Consulting and Training manager director Jim Stackpool says the fee-for-service transition signals a change far more profound than revenue, but by and large advisers - at least the ones who seek out his services - are prepared to make the leap.

"We have always operated from the space that clients want their outcomes far more than they want the adviser's products," Stackpool says.

"We've worked, I like to think, at the vanguard of the advice practices where most of the advisers we've worked with have always grappled with the concept of a commission or a trail base being more aligned to the quantum of product that's being delivered rather than the quality of advice that's being delivered."

Clients have been at the mercy of their own time-poor lives and complex products offered as part of a complex service, Stackpool says. He adds that changing financial advisers is seen as stressful and time-consuming, akin to changing banks or telephone providers.

However, the balance of power is set to shift.

"There's a false confidence being built into most of the adviser-client relationships, but when it's challenged - and it will be challenged - clients will go to their advisers and say, 'What's your value proposition because, comparatively, you sound expensive to me,' Stackpool says.

"I think that's the day when the advice industry either becomes a profession or jumps back with its tail between its legs and goes back to selling products."

A ban on most financial advice-related commissions is set to come into effect on 1 July 2013 as part of the government's Future of Financial Advice (FOFA) reforms, introduced by Financial Services and Superannuation Minister Bill Shorten.

The reforms include a number of changes, including opt-in, which would require advisers to have clients sign fresh agreements every two years. FOFA also proposes to do away with volume-based commissions, which include payments based on volume or sales targets from platform providers to dealer groups.

However, fee-for-service is the centrepiece of the changes because it so profoundly

changes the way the industry collects revenue by doing away with upfront commissions as well as ongoing payments, or trailing commissions.

"These reforms are crucial to further developing the industry and improving the trust and confidence that Australians have in financial advisers," Shorten said when he unveiled the reforms three months ago.

"We will continue to consult with stakeholders in the lead-up to the release of draft legislation later this year."

His office has said the draft legislation will be introduced in August or September and finalised by the end of the year.

"I strongly believe that professional, well-regulated financial advice can be of great benefit to a growing number of Australians and I believe our Future of Financial Advice reforms will encourage more people to seek that advice in the future," he said then.

No escape

It's hard to argue with Shorten's statement given that only two in 10 Australians seek out financial advice, a statistic that adviser-member organisations are keen to improve.

To that end, the FPA has set the deadline for making the switch to fee-for-service at 1 July 2012, a full year earlier than that contained in the government's proposal.

"We announced in October 2009 that our members would be required to make this change," FPA general manager of policy and government relations Dante De Gori says.

"Those who acted early have a competitive advantage. Some members are getting the benefit of that because they can differentiate their service."

Asked whether the FPA was concerned that the earlier deadline would prompt members to quit the organisation, De Gori said no.

"No-one can avoid fee for service by leaving our membership. Under FOFA, they will be required to change irrespective of whether they are a member or not. You can't escape fee-for-service by leaving the FPA.

"Also, our members have known about this since 2009 and those that did not transition are going to be left behind both professionally and commercially."

The opposition has said it would undo FOFA if elected, but De Gori says not even a change of government will derail the shift to fee-for-service.

"They may undo opt-in and the banning of insurance commissions in super but not investment commissions," he says.

Paragem Dealer Services managing director Ian Knox says the industry's focus has disproportionately been on the adviser and the adviser's practice.

"It's quite clear that the revenue certainty comes from the relationship with the client and the service to the client. I think FOFA will bring that more to the front," Knox says.

"That, in part, reflects some of the discomfort that the planning industry has experienced with companies that have enjoyed recurring income for limited contact with clients and that's what FOFA is trying to change."

However, industry surveys over the past five years show financial advice practices have been steadily making the transition, according to Investment Trends analyst Recep Peker.

In fact, the financial planning research house's latest available survey on advice practice revenues shows planners get 55 per cent of their revenue from commissions,

down from 70 per cent in 2006, according to Investment Trends October 2010 Planner Business Model Report, the latest available.

Another 40 per cent of revenue comes from fee-for-service, up from 30 per cent in 2006. Of that 40 per cent, 22 per cent, or slightly more than half, is from asset-based fee-for-service. A further 5 per cent comes from volume rebates.

The nationwide survey is based on responses from 1662 financial planners, about 10 per cent of Australia's financial planning industry.

However, the big shift comes from responses to where advisers expect their revenue to come from in 2013. A majority of respondents said they expect to make most of their money from the fees they get for providing service to clients.

In 2013, financial planners expect to be receiving 58 per cent of their revenue from fee-for-service, which includes 23 per cent from asset-based fee-for-services, the survey showed. They expect to make 39 per cent of their practice revenue from commissions.

"One caveat around these numbers is that these results came before the government announced a ban on commissions for risk products inside super, so I expect the anticipated level of revenue from commissions would be a bit lower now," Peker says.

He adds that although planners will be receiving more revenue from fee-for-service, they expect the asset-based portion of that to shrink in the next few years.

"Instead, more revenue will come from fixed-rate fee-for-service and hourly-rate fee-for-service," he says.

Early-mover advantage

Dixon Advisory managing director Alan Dixon says the company, founded in 1986, has never operated on a commission basis.

"Daryl thought this change would come a lot sooner," he says of his father and company founder Daryl Dixon, who is the advice and funds management company's executive chairman.

"There's a group of people at Dixon Advisory who have never seen the other side," he says, referring to the fact they've never worked under a commission-based system.

"We also have a number of advisers who've come from a commission environment and one of the things that probably led them to take work here was that they enjoy the fee environment much more.

"It can be harder initially because you have to have a discussion about what your value proposition is, but it makes it clear for the client that the relationship is between you and the client and not you and the product."

The business has 16 financial advisers across the country and $4 billion under advice.

"I've yet to meet one client who doesn't love fee-for-advice," Godfrey Pembroke managing director Tom Reddacliff says.

"Clients find it very transparent, it's agreed, and they know what they're paying for is the advice they're given," he says.

Godfrey Pembroke, owned by National Australia Bank, has about 180 advisers in 60 locations. It has $5 billion under advice.

Premium Wealth general manager Paul Harding-Davis says about three-quarters of the group's businesses are accounting practices with financial planning practices, so fees are a key part of revenue.

"As a dealer group, we charge a fee-for-service to our guys for the service we provide and most of our guys are already fee-for-service in one form or another."

Premium has about 20 practices, 50 representatives and $2 billion under advice.

Godfrey Pembroke was one of the first large adviser networks to start chipping away at commissions, giving it an early-mover advantage. It removed volume bonuses in 2004 and commissions on super and investments for new clients in 2006.

The group is now taking the next step, introducing fee-for-service to clients on its books before 2006.

"In 2004, we removed volume bonuses; in 2006, we removed commissions on superannuation and investments," Reddacliff says.

"In April 2010, we announced publicly that we would be moving towards that for our existing clients - so the pre-2006 clients - and then we also announced that we would move to fees for new clients on insurance and debt.

"On 1 October 2011, our licensee standard will change so that it covers fee-for-advice on all superannuation and investments clients.

"On 1 October 2012, our licensee standard will change again to fee-for-advice on new clients regarding insurance inside and outside super and debt as well, so mortgages and things like that."

He adds that some advisers are also selling portions of their fee book into Godfrey Pembroke's buyers and sellers register. The register, called Connect for Growth, allows businesses, usually those that have been in operation 20 years or more, to connect with advisers, usually those starting out, who want to buy a client base.

Redacliff says another attraction to the fee-for-service model is its ability to future-proof an adviser's business.

"When more of your revenue is determined by the client and the adviser together, that revenue is more future-proof than if it's determined by a product provider," he says.

Redacliff prefers the term fee-for-advice to fee-for-service. Either way, he says the model has attracted new business to Godfrey Pembroke advisers, mainly from solicitors, doctors and accountants.

"We find that there is a connection between the fee-for-advice story and attracting new clients, particularly in the [law and accounting] professions. That's the nucleus of our game plan," he says.

He says professionals find the fee-for-advice model a natural way to conduct business because they, themselves, bill their own clients that way.

"They find it's a match, which is good for us. It has a cultural alignment with the way they do business. When you create greater alignment, people are more likely to want to do business with you," he says.

Challenges abound

As financial advice practices large and small scramble to meet the reform deadlines, one glaring omission is the lack of actual legislation, leaving advisers to set multiple plans in train that may or may not hit the mark when the laws are released later this year.

"There are some things you can anticipate accurately, some things you can anticipate, and some things for which you have to have plan A and plan B," ANZ advice and distribution general manager Paul Barrett says.

"Take, for example, the banning of conflicted payments. We don't yet know how it's going to apply in practice," he says, adding even the term 'fiduciary duty' could do with a bit more clarity.

"So the biggest obstacle at this stage is lack of detail. However, the spirit of what is trying to be achieved here is well understood, which means that as a business, you can anticipate quite a lot of what needs to be done, particularly commissions and the banning of commissions and the move to fee-for-service.

"In that particular regard, we can get well prepared for that and get on with it," he says.

However, Barrett says the insurance side of life poses even greater challenges than investment when it comes to the switch to fee-for-service.

"When it comes to trying to anticipate how we will operate in a fee-for-service world giving insurance advice, and the potential distortions between inside super and outside super, there's still a bit of work to be done there because we have to understand how the product manufacturers are going to handle that issue," he says.

However, others say putting a value on their own product - the advice they provide to clients - is even more daunting.

Reddacliff says Godfrey Pembroke advisers have about 150 clients each, which he says is three times fewer clients than the industry average and the basis of the group's bias towards the affluent client segment.

However, he says the group does not have minimums and maximums, as private banks do, when it comes to providing advice.

Its advisers are self-employed so it's up to them, he says.

"The adviser determines that a certain fee is economical for them, so in other words, knowing their cost base of delivering this advice - that's very important in working this out - if they decide to take on a client, that's their prerogative," he says.

"All we insist on is that it's done on a fee-for-advice basis. When it's done on a transparent fee-for-advice basis, you really need to be charging a profitable fee or you're doing pro bono work. It's either A or B."

Stackpool says many of his clients struggle with defining their value proposition and,

therefore, their pricing.

"The fundamental issue is, what are you worth? Where's the value," Stackpool says.

"That's going to be hard for the old-style adviser who I think is 60 per cent of the marketplace," he says, adding that the old-school adviser is the one most likely to put up a for sale sign in the current environment.

Most organisations have introduced programs aimed at helping their advisers profit under a fee-for-service business structure.

The FPA is running workshops to help members meet its fee-for-service deadline, which is less than a year away.

Earlier this month, Barrett was among a group of ANZ executives who unveiled FutureReady, a program designed to help advisers build a fee-for-service proposition.

Barrett says the rollout of FutureReady is underpinned by workshops at which planners can learn to build a value proposition and market it.

However, Stackpool says the starting point is as easy as a dialogue and, although the changes may induce jitters, he has no sympathy for anyone who won't have a go.

"Just pick 10 clients, pick two clients, and have a slightly different conversation with a different approach to pricing. Just have the courage to pick two before you turn your back on it and say, 'the politicians are taking us over, it's a socialist state, we've got to vote the government out'. Just have a crack at it," he says. «

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