Financial Services

Fees, Alignments and Bias

There has been an avalanche of comment in the media over the past year or so relating to the nature of products, fees and advice in the financial services industry. Some has been informed, some misleading, some self-serving and some hysterical. For some time now there has been a campaign of adverse comment on the receipt of commission based remuneration on the basis that it biases advice and can distort the provision of services.

There is at present a parliamentary inquiry addressing the provision of financial services including how advice is provided, how products are sold and how advisers and fund managers are remunerated.

Our purpose in writing this article is to provide a perspective to assist client understanding. We have provided retirement advice and continuing care services to clients for nearly two decades, including both fee and commission based services. It is valuable to be able to look through the media reporting at some key issues.

Events of Recent Years

In a boom activity becomes frenzied and investors incautious – demanding of high returns and keen not to miss out. Some product providers and financial services businesses are predatory. They employ poorly qualified staff and drive them to sell product. Investor borrowing is promoted to provide the capital to purchase products. Risk compounds. Incompetency and greed flourish. The imperative to place product rather than provide advice drives business revenues, whether fee or commission based.

With the end of the boom and the near collapse of the world banking system these excesses were brought into sharp focus. Excesses such as those of Storm Financial, Westpoint, Great Southern Plantations, Opus Prime and Fincorp are well known. The elements of greed, ignorance of risk and inflated expectations flourished. Sometimes large fees were involved, sometimes commissions. And some banks were complicit in the encouragement of high levels of borrowing by individuals to purchase high risk assets and portfolios. The absent essential appears to have been careful, measured and appropriate planning and advice.

Good Planning

We have written widely over the years about what constitutes good planning, particularly in our core area of retirement planning. It addresses a client's situation, needs and objectives in terms of future planning periods. It looks at lifestyle objectives and the income and capital needed to service them across the planning periods. A model is developed taking account of taxation rules, superannuation rules, social security rules, risk and investment options. Only then are appropriate products chosen to fit the strategy.

Over time things change – personal circumstances, super rules, tax rules and investment options. The maintenance of a model is an ongoing process. It requires tuning from time to time, and an ongoing relationship between the client and their adviser. Good planning is relationship based.

Conflict of Interest in Advice

Too much of the advice given in this industry does not satisfy the above standard. But nor is it of the type reflected in the extreme examples listed above.

In undertaking any reform it is important to look at the core operation of the wider industry and the agendas of those that occupy it.

In Australia, banks are a powerful force in the financial advisory industry. They have extensive product distribution networks through their branches. And they own major fund managers. (For example major fund managers such as Colonial First State, MLC and BT are owned by banks).

Many banks both own fund managers and employ financial advisers. Inevitably, there is the potential for a conflict of interest. The employment relationship has the potential to influence the products which the adviser recommends. And banks have a revenue interest in building their funds under management.

A similar situation can exist with advisers who work directly for, or are contracted to, major superannuation funds. Some time ago we had an interest in tendering for the provision of advisory services to the members of a major super fund - until we read their tender document. The terms of the tender required that the fund's products be used for investments 95% of the time.

We did not tender. It would have compromised our integrity to have done so. A national fee based adviser network submitted the successful tender.

Fund managers, including superannuation funds, are principally asset managers, seeking to build funds under management. Too often advice functions primarily as a mechanism for doing so. Many of the Statements of Advice we see are legalistic, jargon riddled and generic. They are documents designed to generate an immediate transaction rather than build an advisory relationship . For in many such instances the adviser and the client will never meet again.

The potential for conflict of interest in advice exists irrespective of the method of remuneration.

Fees and Commissions

Fee or commission arguments have centred around bias and conflict of interest. It is unsurprising that the funds management arms of some banks and some large super funds argue against commission based payment on the basis of 'conflict of interest', for it does not fit their product distribution model.

We have discussed above the potential for conflict of interest which arises from employment relationships, irrespective of the method of remuneration.

That is not to argue that potential conflicts of interest do not exist elsewhere, whether in fee or commission based models. They do. It is imperative that they are fully disclosed to clients, that clients understand them and that they are able to make a choice.

Many years ago Tony Muston, a leader in the provision of financial advice and client services, said *'the thing about commissions as a method of payment is - clients like them'.*

It is worth commenting on the reasons why this might be so. One of the reasons may lie in the fact that clients prefer to have the cost of services amortised over time from their investment portfolios, rather than by paying directly. It can be more efficient, or it may in some instances simply be an emotional preference.

In some cases it will also enable people to obtain the services they may not otherwise be able to afford.

It can also depend to some extent on the models that are associated with ongoing care services.

Ease in Ongoing Relationships

Our costs of providing services to clients over the long term have been met in part by service commissions and in part by fees.

Our clients access services and appointments as required and we maintain contact through our reports and regular publications, as well as by telephone discussion and through client update meetings. Depending on their situations and circumstances, at some times clients will underutilise services and at other times will overutilise them.

Our clients understand that when they need to ring, or to come in, they do not have to think about any direct immediate cost. Ours is not an individual time-costed model. If we spend half an hour talking to clients about their recent holiday, their family or their newest grandchild, they are not worrying about the direct time costing of the appointment.

It is true that in such a model there is an element of cross subsidy between clients. Some use or need services more than others. At certain times, life crises or other events require intensive provision of services. All are covered by the model.

It is also true in such a model, that our wealthiest clients are to some extent subsidising the services to those clients who are less well off – as indeed are we. But that is the sort of society we believe in. We refuse absolutely to categorise our clients as A, B or C class as many institutions do – scaling their services according to their clients' wealth. All of our continuing care clients have access to all of our services to the extent required by their situation without additional payment.

There is a peace of mind and an ease of relationship that comes from such a model. There is time for advisers and clients to get to know each other – all of which adds value to the nature of the planning relationship over time.

The Future

We are neither owned nor controlled by any financial institution. As such we do not have alignments which require us to place funds with any particular institution. Our focus remains on the quality of advice, ongoing services and the maintenance of fair fee structures.

We trust that the outcome of the present inquiry does not lose sight of the role of small organisations such as our own in delivering quality advice and in providing ongoing and affordable support to clients over the long term.

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