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# stating the obvious

The only way for financial planners to be recognised as a profession is to adopt a GENUINE fee-for-service model. Sadly, there is a lot of entrenched resistance.

Recently, some financial planning industry apologists have proposed that the industry has moved on from the remuneration debate. It is suggested that as a result of intensive education, training and compliance activity, most modern financial planners act ethically and in the interests of their clients. Therefore, it is argued that the form in which remuneration is paid (whether percentage-based commissions or fees) has become irrelevant. This argument is proposed in the vain hope that the industry's deep conflicts of interest will be minimised because, after all, "most planners really want to do the right thing", irrespective of how and by whom they are paid.

This desire on the part of most planners is undoubtedly true; just as it was true for the majority of life insurance agents in the bad old days. Some supporters of commission-based arrangements are personally offended by the proposition that their advice could be biased, even though they must sell a product to put food on the table. It appears that they just don't understand, or don't want to understand, that receipt of commission puts a financial planner in an impossible position of conflict (or at least an irreconcilable appearance of conflict).

## CONFLICTS OF INTEREST

The conflict exists at several levels. The first level is that a third party is paying the remuneration, not the client. The nature of this relationship is best described by the old proverb: he who pays the piper calls the tune. The second level is that a product must be sold to receive remuneration in the first instance; and the third level of conflict is that some advisers will be tempted to

recommend the product that pays the highest level of remuneration. As a result, commission (and its inherent conflict) must always be inconsistent with being a professional adviser.

As an alternative to commission, some financial planners rebate commission to their clients, and charge an annual amount pursuant to a so-called fee-for-service scale that is based on a percentage of funds under advice (FUA). This is preferable to a commission, although it still requires that a product be sold (or that a client has assets on which to apply the scale).

A minority of financial planners have improperly used both of these remuneration models. Some planners have arranged margin loans to create FUA; others have advised clients to liquidate real estate in order to invest the proceeds in managed funds; and others have even advised clients to commute government-funded indexed superannuation pensions in order to free up capital for investment in products.

The simple fact is that a person's behaviour will be determined by the manner in which he or she is financially rewarded. Therefore, any remuneration model that is constructed around the sale of products will result in the sale of products. This is hardly a surprising outcome.

On the other hand, a fee-for-service that does not rely upon the sale of a product nor upon the existence of assets, avoids all the conflicts outlined above. This form of fee does not have to be based purely on an hourly rate; although it would certainly be expected that time would be a significant factor in its derivation. The main issues are that the fee is not based on FUA, that it is disclosed, and that its quantum and/or calculation methodology

is agreed by the client in advance of the work being performed.

## MINIMISING ABUSE

Of course, this form of fee-for-service can be abused. It's just that the opportunities for doing so, both real and perceived, are substantially reduced. Conflicts of interest are minimised and independence is enhanced. It is the only remuneration model that is consistent with professional practice as a financial planner.

Some will argue that clients should be offered the option to remunerate their financial planner by any one of the above methodologies. This is the let-the-client-choose model adopted by the principal industry associations. Others will argue that poorer people will not receive much-needed advice unless it is via a planner on a commission. The argument here appears to boil down to the questionable proposition that some advice is better than no advice.

These arguments obscure the fundamental issue of principle. That is, if the financial planning industry wants recognition as a profession, then a fee-for-service model that does not rely upon the sale of a product or the existence of FUA is the only acceptable option.

So, why can't the leadership of the industry bring itself to unequivocally state the obvious? The answer can only be that the structure of the industry has so entrenched the status quo that the perceived consequences which are likely to flow from stating the obvious are simply too hard to face. ☹

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