The ABCs of the Financial Advisers Act

The Financial Advisers Act came into effect on 10 October 2002 and all financial institutions are expected to comply with all its requirements from 1 April 2003, so what can consumers expect from financial advisers and their representatives? What are the likely benefits to consumers, and what are the things that they should look out for?

In this, the second installment of a three-part series looking at the Financial Advisers Act from the consumer's point of view, David Choo moves on to the letter 'B' to examine the business of financial advisories.

Evolution of an Industry

Given all the things that financial advisers are empowered by the Financial Advisers Act to do, they should all be partying and singing with gusto, "There's no business like FA business!" Here's why they have good reason to celebrate.

The Financial Advisers Act, or FAA, has opened doors to many new businesses. Once, insurance agents and brokers could only distribute life insurance products, but now, as financial advisers, they can offer life insurance, general insurance, unit trusts and, if they so wish, futures and foreign exchange as well, so long as they obtain the requisite licences.

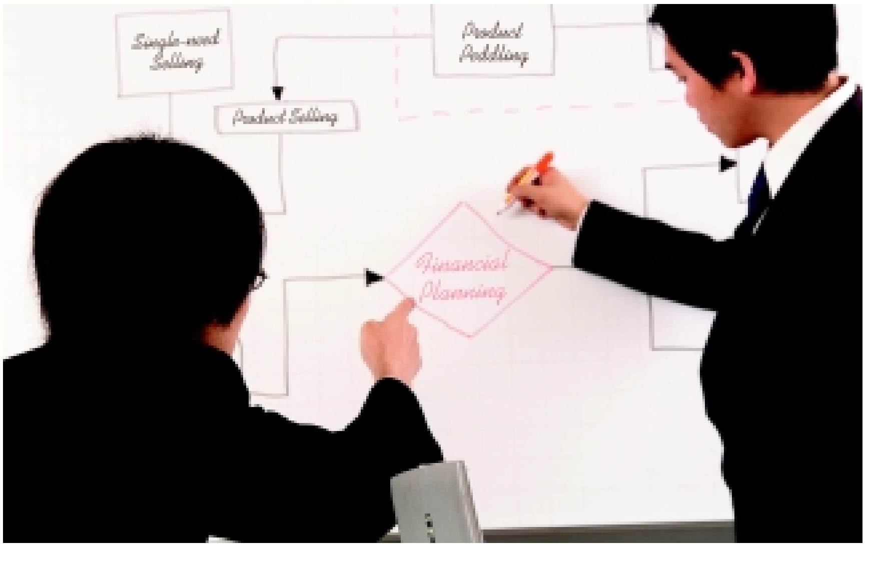
A second cause for celebration is that FA (financial adviser) firms are being courted by banks and stockbroking firms to recommend clients for housing loans and a host of other products. Meanwhile, FAs who move into financial planning also find that tax consultants, accountants, lawyers, trust companies and real estate firms are keen to refer business to them, and vice versa. Firms and individuals who introduce business to FAs can now receive 'introducer' fees officially.

The wider spectrum of business open to FAs is, of course, both a challenge and an opportunity. Because the new regime also enables banks, stockbroking firms and insurance companies to carry and distribute new products, licensed FAs face stiff competition and they have to find a way to compete effectively, efficiently and profitably.

Some FAs are understandably daunted by this task and lament the decline of the "good old days" when they needed only S$2 in paid-up capital to start a business, compared to the minimum S$150,000 needed today to advise on life insurance and unit trusts, and S$300,000 to branch out into general insurance as well. Back then, they also only had to pass one exam, not the slew of tests now in place for all the different product classes.

On the other hand, there are those optimistic FAs who are embracing market liberalisation and finding that these are the best of times. Nevertheless, there are still three important choices to be made. Do they, for example, want to be a financial adviser or an independent financial adviser (IFA)? Will they specialise in distribution, or will they manufacture their own products as well? And do they intend to be a one-stop station for their clients, or specialise in just one or two lines of business?

Last month, we explored in some detail the differences between IFAs and FAs, but,



as we can see, there are other distinctions of which clients should be aware.

To distribute, or not?

Life insurance companies, for example, historically used to manufacture and distribute their products using their own tied agents. But in the last few years, several big international insurance companies have decided to concentrate on manufacturing products and leave the distribution to FAs and brokers.

There are good reasons for doing this. It is cheaper to distribute through third parties, and the liability is borne by those third parties, whereas liability is assumed by principals in the case of tied agencies. Distribution is also very labour and training intensive, and smaller insurance companies can find it hard to recruit agents, so they use third parties to enhance their distribution network.

AVIVA is one example of a firm that has chosen not to use the tied-agency system, and others may soon follow suit. Fund management houses that specialise in manufacturing unit trusts are other good examples of firms using third party distributors like banks, IFAs, and stockbrokers.

One-stop station or specialist?

Since time is money, clients generally favour one-stop stations, and they are not the only ones. FAs also find that it allows them to cross-sell different products, keeping them in constant touch with customers and reducing competition. Many firms that started with one product line have added others in response to clients' requests and needs.

The key question is whether the FA is able to handle the wide range of products competently. Apart from examinations and product knowledge, there are training and competency requirements and a host of rules regulating the distribution of different products. What is emerging is that it is very hard for one person to be proficient and competent in all the product types.

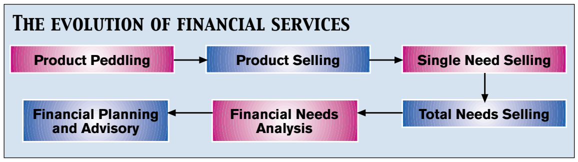
But it is possible for an individual to become more and more expert in one or two product types over time, and rely on others in the same firm for their knowledge of other product types. A team approach is one way forward – who says financial advisers must work alone?

We have certainly come a long way from the product peddling and single-needs selling of the past, but moving to financial needs analysis, not to say financial planning, is far from easy. Each individual adviser and FA firm has to take an inventory of their strengths and weaknesses.

> **A team approach is one way forward – who says financial advisers must work alone?**

We can definitely see a change in profile from the agents of the past to the new generation of financial adviser today. The new FA is more educated, and more adept at planning and processing. He looks at his business as consulting and advisory, rather than just selling. This is not to say that there is no selling as, in one sense, everyone is a salesman, but it underlines the importance of building a business relationship rather than just making a series of sales. Hopefully we have seen the last of the scenario in which a salesperson sold the same product to everyone in the same office, irrespective of their sex, age, job and other differences.

In contrast, financial advisory business starts with thorough fact-finding, followed by analysis, recommendation, implementation, monitoring and a review process. Big institutions like the banks, stockbroking firms and insurance companies have the deep pockets to be one-stop stations, but will have to break their moulds and do things differently from the way they have been done over decades past.



Licensed FAs, while limited by their finances to some extent, should be prepared to invest in management and technology, finding market niches and areas of strength on which to concentrate. The high cost of setting up and running an FA firm is, nevertheless, one deterrent to aspiring advisers.

The ideal business model is somewhere in between the big institutions and the emerging IFAs. For the sake of clients' interests, such firms would have to be able to offer a wide range of services and, most importantly, a wide choice of products from a big group of product manufacturers. Over time, a few of the local IFAs will emerge to lead the pack, but they should not lose sight of their raison d'être, which is to serve clients' interests best.

This means that they should offer good financial advice and competitive products to meet clients' needs. They must process all the information out there and use their financial know-how, market knowledge and connections with the different market players to give appropriate, fair and objective advice and recommendations to meet identified needs.

How will the financial services industry develop? How will the market players shape up? The jury is still out. Perhaps it is still too early for any financial adviser to celebrate. There are indisputably opportunities galore, but it takes entrepreneurship and skill to translate these into good business. And as they say, you need the 'x-factor' for that. Si

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