

# Fees Matter

## WHO CHARGES, AND FOR WHAT?

Agents and brokers charge commissions while financial planners typically charge fees, but compensation is not always so straightforward. No remuneration model is intrinsically superior to any other, so weigh up your options and keep an eye on all the charges.

By David Choo

For decades, insurance agents and brokers have been compensated by commissions, while financial planners offering advice and solutions have been charging fees. Planners who also sold products to their clients received commissions as well and, in some instances, would waive their fees (either in part or in full) if the clients bought products from them.

Then came the Financial Advisers (FA) Act, with new compliance requirements for disclosure, recommendations, training and competency, not to mention a lifting of the ban on rebating commissions. The Act also caused quite a stir because of its stipulations regarding the use of the word 'independent', and gave rise to a rethink about how financial planners and advisers should be remunerated.

The Monetary Authority of Singapore (MAS) stated its presumption that financial advisers are independent and objective if they are compensated by fees and do not receive any commissions (or, if they do receive commissions, they rebate these fully to clients). Financial advisers are not, on the other hand, presumed to be acting independently and objectively if they are compensated by commissions. From this it follows that independent financial advisers

have to show they are not influenced by the commissions received from different products and product providers (although if the difference in compensation is less than 20% then that is deemed acceptable).

All of which left financial advisory firms facing a difficult choice between operating as a financial adviser (FA) or an independent financial adviser (IFA). Some nine months after the Financial Advisers Act came into force in October 2002, fewer than 10 financial advisory firms out of over 30 have chosen the IFA path.

In the meantime, the idea of rebating commissions met with a concerted response from the Life Insurance Association of Singapore (LIA), which decided not to support the idea. Their public statement provided several reasons for this stance, the main point being that the commission system has served the industry well and agents deserve their commissions because of their efforts in training, sales and service.

By and large, licensed financial advisory firms supported this decision and the rebating issue was put to rest, though at least one advisory firm has decided to depend wholly on fees, which means that they will offer a full rebate of all commissions to all clients, no matter how big or small the amount in question.



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## Methods of payment

Within a short period, three remuneration models have emerged: commissions only, commissions-based (in other words, commissions and fees where justified), and fees only. But which is the best model, and for whom?

Product providers, financial advisers and clients have conflicting interests. Most clients, for example, want good products at cheap prices, but financial advisers want to be fairly, if not amply, compensated for their efforts and cannot be expected to run viable businesses if they are not. Product providers, on the other hand, want to lower distribution costs whenever they can to make themselves as profitable as possible.

If product providers pay commissions to their agents and to other distributors like banks or financial advisers, on the surface

it matters little whether these distributors rebate the commissions to clients. But if one distributor rebates commissions to clients yet agents are barred from doing so, then the product provider's agents start to lose business.

Product providers would then have to decide whether it is in their interests to create this unfair competition against their own agents, most likely dropping distributors who rebate commissions. After all, if commissions are given to distributors only to be rebated to clients the product providers might as well save the commissions and improve their products.

In fact, product providers are continually exploring ways to reduce distribution costs, including direct distribution through the Internet, but it has been found that having qualified and committed advisers is still the most effective way of prospecting, rendering advice, closing sales and providing continuing support.

Many financial advisory firms have been considering carefully whether going "fees only" is a good move and have concluded that it is not suitable for a host of reasons. First, as long as the tied-agency system is dominant and relies on commissions, it is prudent to stick to it and retain the goodwill of the insurance companies.

Second, if a "fees only" approach is adopted with the prevailing system of paying commissions over, for example, five years it would be administratively cumbersome to eventually rebate commissions to clients. Indeed, medical plans and personal accident insurance, for instance, come with never-ending commissions, making it extremely costly for "fees only" companies to live up to their word.

The third reason why many long-established FA firms rejected the "fees only" model is that it is very difficult to determine at the outset what makes a fair fee. It is notoriously difficult to determine and forecast the time required to take care of a client. Clients do not always know what products they need, and they have to be careful that the

fees they pay are not higher than those charged by other planners and advisers.

### Why pay fees at all?

Financial planners and advisers are often asked by clients what their fees are for, and the answer is this: clients are paying for the advice and expertise needed to develop a financial plan, not to mention the five areas of any comprehensive solution – risk management and insurance, investment planning, tax planning, retirement planning and estate planning.

But given that there are financial planners and advisers willing to provide their services for free, clients need to ask what the difference is between the planning and advice of those who charge fees and those who do not. There are no published surveys that deal explicitly with this issue, but I am eager to see one confirming my suspicion that any differences are not all that significant for the majority of plans.

The areas that non-specialist financial planners focus on – wealth protection, wealth accumulation (investment), wealth preservation (retirement planning) and wealth distribution (estate planning) – are not particularly specialised. Tax planning, meanwhile, is usually referred to tax consultants, and when it comes to legal matters like wills and trusts it is advisable to involve a lawyer in the proceedings.

What the financial planner is able to do is help the client by identifying areas of concern and suggesting ways to sort them out. But the client will only know what he needs at the end of the planning process, not the beginning. If the planner's business is based on a "fees only" approach, then a client will have to pay those fees even if it turns out that all their needs are taken care of, and even if he decides not to go ahead with the plan for one reason or another.


Does that mean that there are no virtues to the "fees only" financial adviser? No, it does not. Clients who have complex problems may need to go to specialist

financial planners who are experienced in that field. If a client has assets in many countries and faces complex estate-planning issues then he will have to seek out expert advice, in which case a financial planner may have to recommend a more specialised alternative.

One often wonders why lawyers and tax consultants are able to charge fees. One reason is that they do not have products to sell – their advice is the 'product'. The second reason is that clients have an objective need for legal and tax advice, usually when they encounter difficulties or need to avoid a problem. There is also a certain degree of complexity in law and tax matters. Financial planning is not easy and is certainly just as important as legal or tax advice, yet it is often perceived to be less complex.

So what is the unique selling proposition of the financial planner or adviser? What makes them different from agents or brokers? What counts is the knowledge and experience in helping clients to think through their plans and implement strategies to improve their quality of life.

My view is that, under the present circumstances, someone providing planning and advice should agree on fees and consider the sale of products separately, deciding later whether it is appropriate to waive those fees, partially or fully, if the client purchases products from him. There are sufficient safeguards in the Financial Advisers Act, its regulations and notices to ensure that advisers give clients objective advice and good products. Independent financial advisers in particular have to comply with strict rules of "independence" and should be expected to take care of their clients' interests.

All things considered, it pays to be careful about fees because they really do matter. 

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