Paying for the treasure

How you pay for financial advice can still be a dilemma, writes **Tony Kaye**

WHEN it comes to how a financial adviser charges, one thing is certain — there are no rules.

While advisers must disclose all fees and commissions by law, how they charge is still entirely up to them. And with investment returns having slumped into the negative during the past 18 months, those fees are coming under close scrutiny.

Ongoing fees

For years, managed portfolio investors have been charged fees and commissions on the products recommended by financial advisers.

These fees, including product fees, administration fees and ongoing commissions paid to an adviser, often total thousands of dollars a year.

Here's how they work. Your adviser recommends you invest across a range of managed funds. Once you agree, each fund manager will then charge you a product fee of at least 1 per cent on the value of your investment with them. In addition, you will be charged an administration fee of at least another 0.5 per cent.

And then the financial adviser will also take a cut, usually in the form of an ongoing (trailing) commission paid by the fund to the adviser.

All up, people using an adviser can expect to pay at least 2 per cent of their investment earnings in fees.

Fee for service

A growing number of financial advisers are moving from commissions to set fees based on the services they provide, such as an hourly rate.

"Many investors are simply paying too much in management fees and commissions to their advisers while losing money on their investments," says Harrod Financial Services managing director Rene Coory.

In his new book *What am I paying my financial adviser for?*, Mr Coory says a large proportion of superannuation and allocated pension and managed funds and platform investors pay an average 2.5 per cent a year - about 1.5 per cent more then they need to.

This is, in turn, pushing up losses and reducing average estimated future performance from 8 per cent to about 6.5 per cent. The best strategy to deal with a period of underperformance is to reduce ongoing management fees, he says.

Using a fee structure, based on an hourly rate, means people can save thousands of dollars every year and those savings can lead to hundreds of thousands of dollars over 20 to 30 years.

"But don't throw out the baby with the bath water," he says. "Getting rid of commission fees doesn't have to mean getting rid of your adviser.

"You may want a cheaper set-up, you may not want to pay all the fees but that doesn't mean you shouldn't have a financial adviser on hand."

Hourly rate

Financial adviser Theo Marinis, of Marinis Financial Services, says a lot of advisers have moved to fees for service but he notes that charging an hourly rate is not necessarily best for the client or adviser.

"I don't believe in the fee for service model, like accountants and solicitors, where you get paid by the hour but they charge on a 10 minute basis," Mr Marinis says.

"If you ring them up and speak to them for one minute, they charge you for 10 minutes.

"The problem with a per hour fee is that if I'm smarter than the guy next door and I can do the work for you in one hour, but the other person doesn't know as much and has to do research and spend five hours doing it, he gets paid five times as much as I do on an hourly basis because he's less competent.

"I don't think having only a fee for service arrangement is the way to go. And I don't think a percentage fee regardless of your portfolio size is the way to go either.

"It's somewhere in between, because at the end of the day we've got to get paid but it's got to be fair and equitable from our point of view and also from the client's point of view," Mr Marinis says.

Choice

Financial Planning Association chief executive Joanne Bloch says 82 per cent of planners offer a choice between a fee, a commission or both.

"What's important is that people get advice and that the fees they pay for the advice need to be disclosed, need to be agreed, and need to be transparent," Ms Bloch says.

"The FPA policy is that choice is a good thing and consumers should be able to choose with their financial planner how they want to remunerate them."

"The fee needs to be split, into the advice and product, whether it's dollar or commission, and the financial planner needs to make the fee disclosure very transparent."

"The client needs to be able to understand what the fee is, not only upfront but also ongoing."

The FPA has been in talks with the Federal Government about reducing the cost of advice without cutting consumer protection, including shorter disclosure statements.

"At the moment it's a one size fits all approach, which leads you to having to access fairly comprehensive advice when you may just not need to do that."

This is an inhibitor to people wanting to get advice, Ms Bloch says.

Conflict of interest

Consumer watchdog Choice director Gordon Renouf says conflict of interest remains a serious problem in financial planning.

"We've been concerned about the problem of commission payments for some time," Mr Renouf says.

"We think commission payments create strong conflicts of interest for advisers. They create conflicts of interest between the adviser giving you, the consumer, the best option and their personal remuneration.

"If one product has a greater commission than another then the adviser will be aware of that and even if they're trying to do as good a job as they can they can't possibly not be influenced to some degree by that fact."

Mr Renouf says Choice welcomes the increase in advisers who use a fee for service model.

"Obviously, the consumer has to pay up front, but then they are paying one way or another, so it's better that they are clear about how much the advice is costing than getting advice, which may not be very good advice, that is influenced by commissions," he says.

Buying loyalty

"What many people don't realise is that not only is there a commission on the funds being invested but there is an ongoing commission, which is justified as paying for the planner's time in reviewing your portfolio every year and giving further advice," Mr Renouf says.

"But it's essentially a way to get the planners to stay loyal to a particular product."

"A good percentage of people who make investments with a planner never go back for further advice, so justification of an ongoing commission to the planner is another distorting aspect of commission payments," Mr Renouf says.

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