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Media Release

In defence of fees… and commissions

Sydney: 9 June 2009 – The Association of Financial Advisers (AFA) has today reaffirmed its support of financial advisers, regardless of remuneration model.

AFA CEO Richard Klipin says the way an adviser charges for services does not make them a better or worse adviser and simply being fee-based will not guarantee consumers receive better quality advice or that advisers will build better businesses.

“While some of the recent debate on this issue has been spot on, some has been filled with distortions that cloud and hamper the issue,” he says. “It’s time for some clarity.”

Brief History of Adviser Remuneration Models

Advisers emerged from two main industries - the life insurance industry and the stock broking/managed fund industry. The remuneration model for both these industries was commission-based. Financial Services Reform (FSR) legislation drew the distinction between advice and product and the Statement of Advice (SOA) became the disclosure instrument designed to ensure transparency and protect both the consumer and the adviser.

“FSR has served the community well,” Mr Klipin says. “Whilst not perfect, it raised the bar, created value around advice and ensured the birth of a profession. The question is, where do we go from here?”

In the interests of transparency and the consumer’s right to know, Mr Klipin says the industry now needs to clearly define ‘fee for service’ and ‘commissions’.

Fee for Service: Towards a consumer friendly definition

“If you are going to be very pure – and very transparent – a fee for service is an amount a consumer agrees to pay for a service,” Mr Klipin says. “It may be based on a job cost, an hourly charge or an annual contracted basis. The fee level and payment type is a business and a consumer issue and may be negotiated with the consumer. It must be signed off by the consumer before the service is provided. This amount is then invoiced and settled by the consumer.”

Mr Klipin says the fee structure is prevalent in many professions including lawyers, accountants, architects and engineers and is determined by a range of factors including time spent, resources allocated, value created for the client, etc. “It considers things like margins for overheads, profits and so on,” he says. “Understanding these metrics is the cornerstone of all profitable and productive businesses.”

In the context of financial services, Mr Klipin argues, “If we accept that a “fee” can be directed by a client but we allow that fee to be paid by a product provider, isn’t it still a commission, no matter what you call it? And, as a result, isn’t this kind of “fee” still open to the same conflicts of interest as commissions?”

Commission Model: Towards a consumer friendly definition

A commission is a fee paid for transacting a piece of business or performing a service; it is usually a percentage of the money received from a total paid to the entity responsible for the business. It is paid at transaction time when a product/service is provided and may be paid on a trail/renewable basis.

"Commission/brokerage models exist in many industries and sectors," Mr Klipin says, "In some markets it is an efficient model used to align all interests involved in the value chain. For example, success fees in a merger/acquisition of a business."

In a financial services context the commission level is negotiated, disclosed and signed off by the parties before the service/transaction occurs. The commission is paid by the product provider, out of funds provided by the consumer, to the adviser. It may be in the form of upfront commissions, trails, a percentage of funds under management, a percentage of premium and, in some cases, a combination.

Conflicts of Interest, Disclosure and Transparency

To manage conflicts of interest that occur in both remuneration models, FSR requires all adviser fees and commissions to be disclosed to consumers through the Financial Services Guide (FSG), Statement of Advice (SOA) and Product Disclosure Statements (PDS). In most cases, the consumer must also sign off an authority to proceed.

Mr Klipin says that whilst the remuneration debate is important, the more important issues are been overlooked. They include:

Is disclosure still the best/only way to mange conflicts?
What is good, professional advice?
How do consumers get the best outcomes from the advice relationship?
What does professional really mean?
Is there a "best compensation model" for consumers and advisers?"
Without remuneration choice some consumers may not have access to advice (especially lower income earners)

"The AFA is committed to leading and supporting its members throughout this debate, regardless of how those members are remunerated," Mr Klipin says. "Our mission is to help our members in their role to build manage and protect the wealth of everyday Australians."