Consultation Paper

Financial Planner Remuneration

April 2009

Submissions due Friday 29 May 2009

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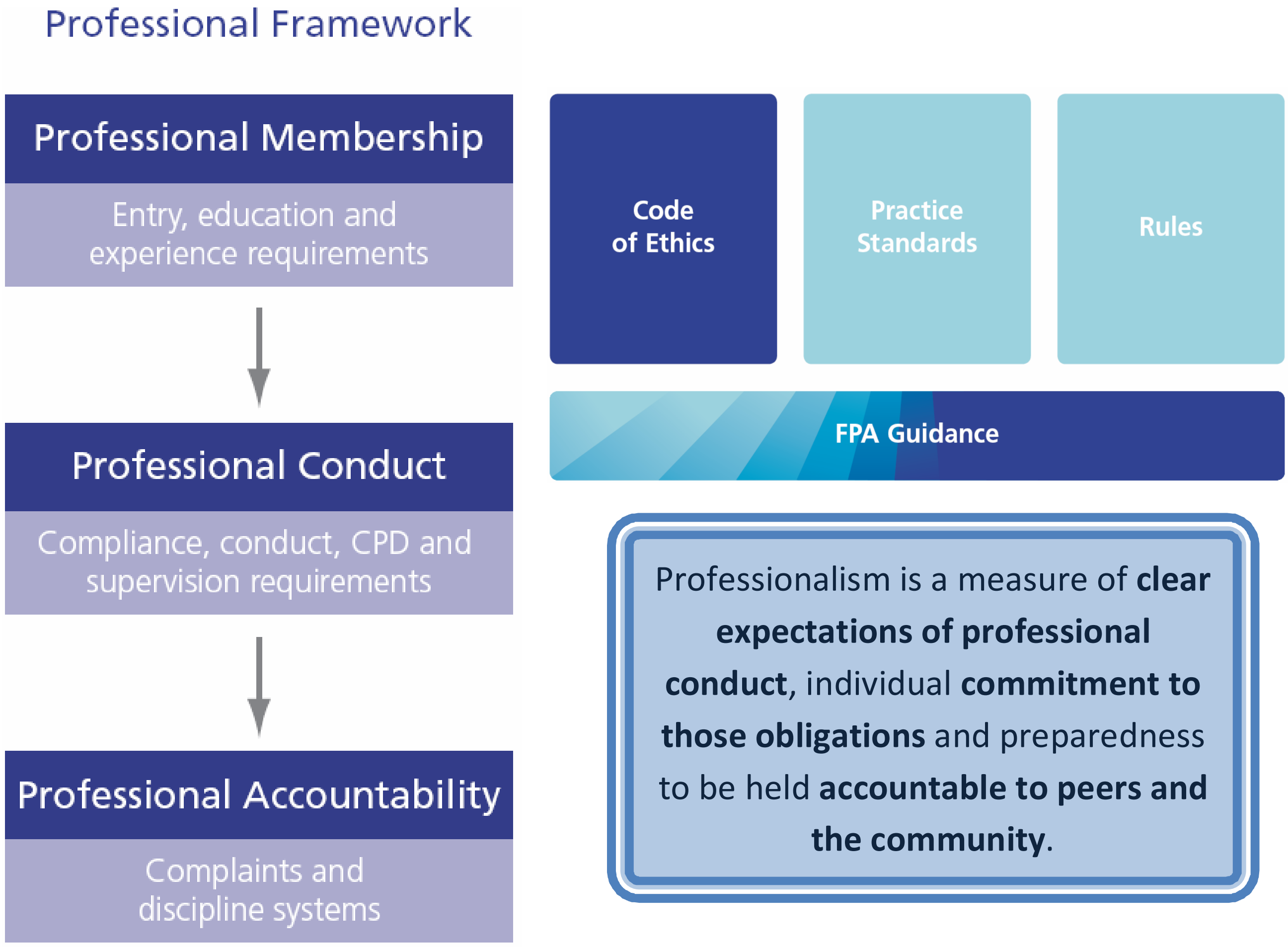
Foreword

In the last few years the FPA has undertaken a significant process to capture through the launch of our Professional Framework and revised Code of Ethics, and Practice Standards what the profession of financial planning means, not only for FPA members, but for the community. This will culminate shortly in the release of a streamlined Code of Professional Practice that draws together all obligations of FPA members to the profession of financial planning.



The FPA has been steadily reviewing and growing our Professional Framework (new Code of Ethics and Practice Standards 1-6 were released in 2008, new Continuing and Professional Development Policy was released in 2009 and the imminent release of Practice Standards 7-8 with the revised Rules of Professional Conduct). This next phase includes the delivery of quality advice and what that entails; consumer capability and the role financial planners can play to enhance consumer understanding and decision making; regulatory changes or clarification required to improve the way we deliver advice; and remuneration.

This paper is specifically about the *remuneration piece of the professional puzzle*.

The issue of remuneration is often cited as a key issue of conflict in the profession but it should not be seen in isolation from the other more significant components of professionalism. The FPA believes that remuneration is only a minor component of professionalism and is not by itself any indicator of professional practice. Remuneration is an important aspect of delivering advice to clients, and we want to ensure strong guiding principles are in place with clear and consistent definitions of the most common charging models.

Professional practice, as stated, is much more than remuneration. Our requirements to meet with our Code of Professional Practice cover the relationship between client and financial planner on many fronts. We want the community to be clear about this, but each component is complex and requires considerable thinking, debate, and review to ensure that going forward we have the right policy to meet the future needs of members and clients.

The process includes the release of policy papers for member consultation over the next few months, starting with remuneration, and concluding with the final Code of Professional Practice.

We look forward to engaging with members and stakeholders on the key components of professional endeavour as we release them, and urge you to get involved in our Member Summits being run through the Chapters, or our email based consultation process.

Background

The FPA last reviewed its policy on financial planner remuneration in 2006 following an extensive process that culminated in the release of the FPA's Principles to Manage Conflicts of Interest. This policy states that financial planners should offer their clients a choice in remuneration, either a fee, commission or both, and that remuneration should comply with the Principles to Manage Conflicts of Interest, which are outlined as follows:

Principle One:	The cost of financial planning advice should be separately identified as a financial planning advice fee in the Statement of Advice provided by FPA Members to clients, and the total fees paid for ongoing advice should be disclosed to clients on a regular basis.
Principle Two:	Where it is appropriate to recommend a product to a client, all FPA Members will undertake the due diligence necessary to offer products which suit the needs of the client and do not bring the industry into disrepute.
Principle Three:	No Remuneration or benefits paid by a FPA Principal Member to one of their financial planners should be biased against or not in the interests of the client.
Principle Four:	Separate corporate governance arrangements should govern FPA Principal Members and all or any related financial services provider and/or entity.

Remuneration continues to dominate the policy agenda, largely as a result of a number of high profile corporate collapses where high upfront commissions were evident, and also because of competition in the superannuation sector between retail and industry superannuation funds. Some practices in the remuneration field that are historic are no longer appropriate nor are they sustainable going forward as we embed professionalism in financial planning, and as we work to align remuneration with advice.

The FPA formed a remuneration policy committee in June 2008 to review our current remuneration policy, comprising representatives from the wider financial planning industry. This paper is the product of the committee's deliberations which seek as a starting point to determine core principles, and appropriate definitions, of current remuneration practice.

The FPA Board, at its Board meeting in March, 2009, approved the principles, terminology, definitions, and charging structures for consultation with members.

Purpose of the discussion paper

This discussion paper outlines:

1. Six suggested principles that should underpin all remuneration practices;
2. The main charging structures in financial planning with definitions of each;
3. How the charging structures will align with the FPA's Practice Standards; and
4. A number of questions to enable feedback.

This discussion paper is intended to:

- **Encourage discussion** within the financial planning and wider community
- **Seek feedback from members and the community**
    i. Please respond to the questions and provide additional comments as appropriate
    ii. Contact: **professional.standards@fpa.asn.au**
    iii. By close of business: **Friday 29 May 2009**
- Enable the FPA to formulate a new Remuneration Policy which facilitates greater understanding; better compliance and improved outcomes for clients and financial planners.

It is the aim of the FPA to achieve clarity as to the various charging (remuneration) models that are in use, to ensure that charging models are disclosed clearly and consistently, and to ensure that these charging models align with advice.

The value of advice is the most important factor in determining whether remuneration is appropriate or not, and everything we do as a profession should focus on qualifying and then promoting that value. Financial planners and their clients also want greater flexibility in the manner in which the fee for advice is negotiated, and managed. Providing advice and product by way of commissions does not necessarily ensure that the cost, and value of advice, is well understood by clients, despite the convenience, and tax benefits, inherent in this payment mechanism. It is also clear that the movement to transition away from the influence and involvement of product providers is well underway already and the FPA recommends a transition that places the negotiating power directly in the hands of the financial planner (and licensee) and their client.

The FPA is well aware of the issues relating to legacy products and life insurance. Our principles and practices canvass the fact that we will have to draw a line in the sand between the past, and the future, to enable sound policy and practice to move ahead. This means that we will need to grandfather existing legacy products from these recommendations and concentrate on new advice, products and services from an agreed date to avoid confusion for clients. We will also need to consider the difficult economic situation and ensure transition plans are able to accommodate client, business and other practical issues.

Guiding Principles

There are three guiding principles that have instructed all discussions and deliberations when developing this paper.

Remuneration should be:

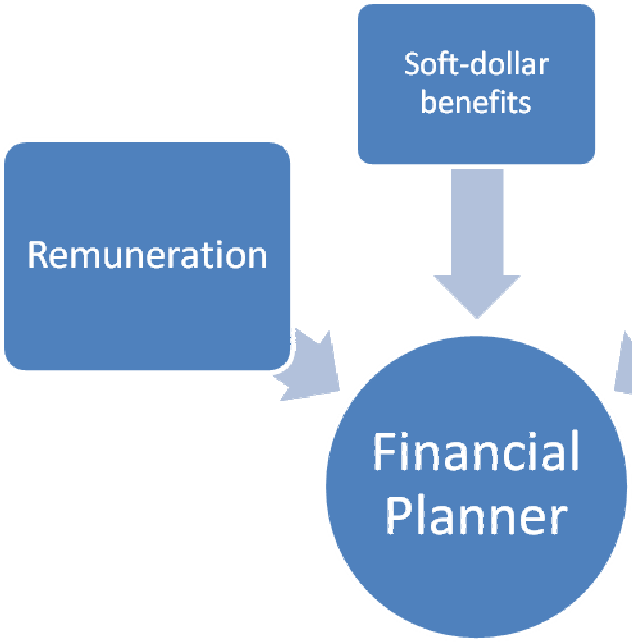
1. Right for the Client First
2. Right for the advice provided
3. Right for the financial planning business delivering the advice.

It was noted that as a result of our global research into remuneration practices:

- The Australian financial planning profession is one of the most transparent and progressive in the world and Australia leads the change agenda to align community expectations with the delivery of financial advice.
- The majority of countries included in our research continue to use largely salaried and commission based advice models although a combination of commission and fee based advice is increasing.
- The Australian financial services system has a well evolved structure, and our definitions and models lead the way. Complexity, however, remains as does the inevitable confusion that emerges from low levels of consumer engagement, literacy and understanding of financial services.
- The FPA has already introduced a number of reforms to remuneration practice that are being discussed in the UK, through the Financial Services Authority's Retail Distribution Review. We note this review because it is most closely aligned with where we are heading and also because we know that ASIC looks to the UK for regulatory information and direction.

What do we mean by financial planner remuneration?

There are three broad types of remuneration at work in financial planning, as described in the diagram below:



1. Remuneration for services provided by the financial planner to their client

2. Soft dollar (or non-monetary) benefits provided to the financial planner by a product provider or licensee

3. Payments made to the licensee for funds under management, sponsorships or other benefits that may or may not be paid to the financial planner.

This paper relates to the first component, which is remuneration payable to the financial planner[1].

The FPA has established rules and processes to deal with the other forms of remuneration, and in joint Codes with IFSA, manages these benefits through the Alternative Remuneration Code and the Rebates and Related Payments Code.

[1] Note that under the Corporations Act, a person may only be remunerated for providing financial services or carry on a financial services business if he or she holds an Australian Financial Services Licensee (AFSL) or holds authorisation from an AFSL.

SECTION 1 – SIX PRINCIPLES

Six Principles for financial planner remuneration

Introduction

It is recommended that the financial planning profession adopt the following six principles to inform the development of standards for financial planner remuneration and to therefore underpin remuneration practice

6 Key Principles for financial planner remuneration	
1.	**Consumers must be able to understand the fees they are paying**
2.	**Consumers must be able to compare the fees they are paying**
3.	**Consumers must be presented with a fee structure that is true to label**
4.	**Consumers must be presented with fees that are separated between advice and product**
5.	**Consumers must agree the fee with their financial planner and should be able to request that the fee is switched off if no on-going advice is being provided**
6.	**Consumers should pay for financial planning services, not product providers**

Building on existing FPA Principles to manage Conflicts of Interest, the new principles are proposed to transition away from product provider influence over financial planner remuneration and to require planners to set their own charges for their advice and services (within the framework used by their licensee), and then negotiate those with their client.

The timing of these changes needs to be agreed amongst our membership, noting that legacy products are difficult to restructure, and also noting the considerable difficulties facing financial planning businesses through these economic times.

It is therefore proposed that we determine an appropriate date, say 1 July 2012, after which all *new* advice, services and products will be delivered using charging structures *that satisfy the FPA's 6 principles*, negotiated between the client and the financial planner and disclosed according to the FPA's proposed model.

Each of the 6 Principles is discussed below:

Principle 1 - Consumers must be able to understand the fees they are paying

1.1. Consumers who are well informed and well educated make better decisions about their finances. Fees have long been complex and difficult to understand, largely because products have become complex, but also because of competition and the need for competitive differentiation.

1.2. The FPA already requires its members to provide information about fees to clients at the point of engagement, [Rules 103 and 104] and for comprehensive fee disclosure including dollar disclosure to be provided to clients in conjunction with any recommendation [Rule 106].

1.3. These requirements complement Corporations Act requirements.

1.4. The FPA has also embarked on work to simplify the Statement of Advice (SoA), including an effort to simplify fee disclosure in the SoA which includes a sample fee table, to assist members.

1.5. Simple and consistent fee disclosure should extend to all documents given to a client.

1.6. All future improvements in disclosure should be focused on consumer friendly language.

1.7. The value of the advice, and the associated cost of that advice, should be clearly conveyed to ensure the client understands the value and the cost.

Principle 2 - Consumers must be able to compare the fees they are paying

2.1 Improving consumer understanding of the fees they are paying is improving comparability in fee disclosure across charging models.

2.2 Disclosure which allows comparability between charging models places consumers in a better position to choose the remuneration model that is best suited to their needs and circumstances, and is consistent with the financial planning recommendations being made.

2.3 Comparability in disclosure assists to manage the inherent conflict of interest between the professional's need to be remunerated for their services and the client's interest in receiving services at the least cost possible. It should enable the client to compare the value they may receive from one professional with that offered by another.

2.4 Remuneration practices which involve the undisclosed subsidisation of financial planning services by a third party such as a product issuer, may be confusing to consumers and prevent fair cost comparisons between remuneration models.

2.5 We have proposed standard definitions that describe the main charging models so that we achieve greater clarity and comparability.

2.6 Consistently with the FPA's existing Conflict of Interest Principles, consumers should be able to understand and determine:

- 2.6.1 The scope and nature of the financial planning services they will receive;
- 2.6.2 The (actual) total cost of the financial planning services they will receive;
- 2.6.3 The estimated cost of financial planning services they would receive under different remuneration models;
- 2.6.4 The fees charged for financial planning services as opposed to the costs of a product.

Principle 3 - Consumers must be presented with a fee structure that is true to label

3.1 We have identified the elements of the major remuneration charging models that are currently operating in the market, and the key features of each model.

3.2 To encourage our members to accurately self-identify with the appropriate charging models for their business we will need to improve standards of representation in marketing and promotion of member businesses and we will need to enforce these standards.

3.3 Standards could be improved by extending existing requirements that marketing and promotional material is not misleading or deceptive [Rule 101] to include 'not likely to mislead or deceive' and to add requirements for specific clarity when making claims of 'independence', and when identifying with a particular remuneration charging model.

3.4 We will introduce specific market representation standards and rules under the streamlined Code of Professional Practice to encourage good practice, and discourage members from making false or disparaging claims about another financial planner's charging model.

3.5 In recommending a strategy or a financial product to a client members should consider and disclose to the client the likely consequences to the client of the use of a particular charging model for the client if the client were to implement the recommendation.

3.6 Members utilising commission based charging models might be required to provide additional information directly to consumers on the impacts of commission based charging. Such information might include:

3.6.1 Comparative information on charging models;
3.6.2 Questions to ask your financial planner about how they charge for financial planning services including the difference between up front and ongoing commissions and associated services;
3.6.3 The potential influences on advice and potential for conflicts of interest that may apply to different charging models.

3.7 The proposed charging models are set out in some detail in Section 2 of this consultation paper.

Principle 4 – Consumers must be presented with fees that are separated between advice and product

The following is a proposed fee disclosure table which separates the costs of product from the costs of advice. Note that definitions are outlined in Section 2 of this document.

Stage	Item	Definition	Industry sector
Product costs	**Product costs**	These are the costs charged by the product manufacturer for the creation and management of the investment/product/service	
	Product administration costs	These are the costs charged by the product manufacturer for the administration of the investment on behalf of the client (this may be incorporated in platform costs)	Recommendation for **Simplified Product Cost disclosure**. **This is outside the jurisdiction of the FPA and is included here only as an indicator of complete disclosure.**
Financial Planning Fees	**Costs for the initial development and provision of advice**	The initial financial planning fee is associated with the initial services provided to the client and reflects the FPA Practice Standards including: • Initial client consultation (often free) • Initial client investigations • Identification of client objectives, needs and circumstances • Analysis of client objectives • Identification, Research and development of suitable strategy recommendations • Identification, research and development of suitable product recommendations • Presentation of recommendations to client • Confirming instructions to implement advice	**Financial Planner requirement**
	Client / product administration costs – Licensee	These are the costs incurred by the Licensee for the administration of the client portfolio/service or the product. Where clients incur portfolio administration costs (often referred to as platform costs) it is suggested that these should be captured separately	**Licensee and product requirement**

Stage	Item		Definition	Industry sector
Financial Planning Ongoing Service Fee	**Costs for the provision of ongoing Advice and Services**	SAMPLE ITEMS Monthly review Portfolio maintenance Quarterly seminar Premium Access	These are the charges incurred by a client for a range of services from the financial planner (or their Licensee). These charges may be incorporated in platform costs. The services should be detailed, and agreed to by the client. The services should be able to be turned off (either as individual components or as a group) with agreement by client and financial planner.	**Financial Planner requirement**

Indirect costs would be disclosed as follows:

Indirect Costs to the Client				
Bonuses and other incentives paid by Financial Planning Licensee and/or product providers		SAMPLE ITEMS Professional conference sponsorship from product provider passed on by licensee to planner for the products recommended in the SOA Practice support payments by financial planning licensee for the products recommended in the SOA	This would incorporate any other form of remuneration or benefit whether direct or indirect flowing to the planner or any associated entity from their licensee associated with the recommendation of a particular strategy or product. [see existing Rule 106] These forms of remuneration may not be cash based. They have the capacity to influence advice or may create the perception of bias.	**Financial Planner requirement**

Principle 5 – Consumers must agree the fee with their financial planner and be able to request that the fee is switched off if no on-going advice is provided

5.1 As with the FPA's Principles to Manage Conflicts of Interest, charges for financial planning services should be determined between the financial planner and the consumer.

5.2 If a client wishes to terminate their agreement with their financial planner, or the financial planner wishes to withdraw their services, the fee should be switched off.

Principle 6 – Consumers should pay for financial planning services, not product providers

6.1 Payment for financial planning services should come from the client's account (or the client's own funds) not the product provider.

6.2 Payment can be facilitated or executed by the product provider once directed or implemented by the financial planner/ licensee.

6.3 In the case of payment for on-going charges these should be matched to regular deductions from the client's account.. Loading an upfront payment to the financial planner or licensee would not be permitted.

6.4 This approach to planner remuneration is designed to reduce the potential for providers to influence planners' remuneration, reducing the potential for bias (and the perception of bias) and improving overall industry sustainability and consumer confidence.

6.5 We recognise that there are implications for legacy products, life insurance and systems and technology. We anticipate working with our members, and product providers, to facilitate a mutually appropriate transition period.

6.6 We also recognise the financial and economic difficulties currently facing all members and note that many are already reviewing their business models and remuneration structures.

An appropriate and reasonable transition period, and the support from the product manufacturing sector are both important aspects to the achievement of this principle. We seek feedback on these issues, potential barriers, and concerns facing members, and suggested timeframes.

SECTION 2 – CHARGING MODELS, TERMINOLOGY AND DEFINITIONS

The following charging models reflect the most common practices in the industry, noting that one or more models might be used.

Charging Models	
Consumer is directly charged	**Consumer is not directly charged**
Hourly Rate/Time based charging – the consumer is billed for financial planning and related services solely upon an agreed hourly or time based rate for those services, plus disbursements.	**Commission** - a fee calculated as a percentage value of the consumer's asset or insurance premium payable by the product provider to the financial planner through their licensee for recommending the product to the consumer. Commissions are not paid directly by the consumer but are paid by the product provider. A commission cannot be switched off and will be paid until such time as the client withdraws their funds or ceases life insurance cover. **Trail commission –** a fee calculated for ongoing service paid for by the product provider to the financial planner through their licensee.
Service Based Charging – the consumer is billed for financial planning and related services purely on the basis of an agreed price for the package of services, and agreed between the planner and the consumer. A lump sum might be agreed based on services, savings to the client by adopting a strategy, or performance, for example.	**Subsidised Advice** – advice is provided 'free' or at a significant discount to the consumer. The costs of providing the advice are met by a product provider such as a super fund or other institution. This also includes salaried financial planners. Costs for advice might be borne by other members of the fund (including those who do not access advice) or paid for by an institution eg salaried financial planners.
Asset Based Charging – the consumer is billed for financial planning and related services by any initial or recurrent fee calculated as a percentage of the consumer's asset(s) where the rate of the fee is specifically agreed between the planner and the consumer. The fee is taken out of the client's product. In the case of recurrent fees the consumer has the ability to switch off the fee.	

SECTION 3 – HOW CHARGING MODELS WILL BE ALIGNED TO THE FPA's PRACTICE STANDARDS and POLICIES

The FPA has under consideration inclusion of charging models and definitions in our Practice Standards. Practice Standards 7 & 8 will be released for member consultation in June 2009 and will cover, amongst other things, Professional Practice and Market Representation, and would be the most likely place to include such definitions.

In addition, we would include relevant requirements relating to appropriate disclosure.

The FPA is also considering amending the Find a Planner facility to include the charging model used by Certified Financial Planners.

SECTION 4 – QUESTIONS TO ENABLE FEED BACK

Please respond to the following questions to help us determine whether this paper addresses remuneration practices, and issues, adequately.

Q1 Do you think the six principles are the right principles? Do you have specific concerns with any of the principles and what are they? Please outline any alternatives or amendments that would achieve suggested changes.

Q2 Do you think that we have captured the key charging models?

Q3 Are the charging models described accurately to reflect business practice, and if not please recommend changes.

Q4 What do you think are the advantages and disadvantages from a financial planner perspective of these charging models? From a consumer perspective?

Q5 Is it likely that financial planners will align with these charging models going forward?

Q6 What transition issues might arise should you decide to convert from an existing charging model to another identified model?

Q7 What transition time would be appropriate – can it be done earlier than 2012?

Q8 Do you agree with the definitions of the various initial and ongoing fees that are outlined in the fee table in Section 1, Principle 4?

Q9 Should the FPA change Find a Planner to reflect the financial planner's charging model/s?

Q10 Should the term "financial planner" only be able to be applied by those who offer fee based charging exclusively?

Q11 Should there be a different nomenclature for advisers that operate outside of the 6 principles discussed here?

Q12 What other comments would you like to make in relation to financial planner remuneration, charging models, and the issues contained in this paper.

Submissions due by Friday 29 May 2009
professional.standards@fpa.asn.au