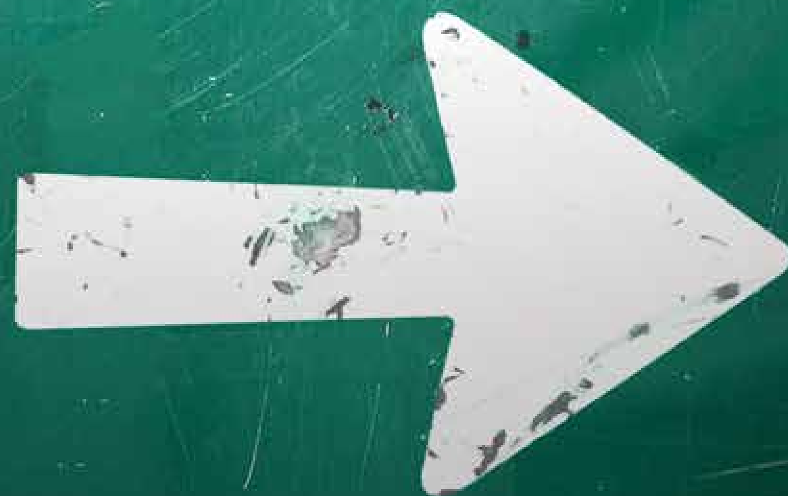


"I DON'T WANT TO FEEL OBLIGED BECAUSE I'VE SAT NEXT TO SOMEONE ON A YACHT FOR AN AFTERNOON TO HAVE TO GO AND RECOMMEND THEIR PRODUCT"

Michael Radalj, director, Eclipse Financial Group

Story by Stefanie Garber

THE EXTRA MILE

Many advisers are showing increased interest in qualifying to become legally 'independent', but what does it take and is it worth it?

IN A climate of distrust between advisers, consumers and major institutions, the label 'independent' has a growing allure. The term holds so much sway over public perception that the Corporations Act has sought to regulate its use, a restriction that only adds to its cache.

Yet while many advisers have dipped a toe into independence – whether by rebating commissions or moving away from vertical integration – few have taken the plunge and met all the qualifying legal criteria.

For advisers interested in going 'the whole hog', we explore the ins and outs of the regulation, as well as how to make your newly reformed practice economically viable.

What it takes to be independent

The provisions pertaining to use of the term 'independent' in financial services are clearly set out in section 923A of the Corporations Act. Yet while the legislation is written in black and white, the text leaves room for shades of grey.

In addition to the law, the Independent Financial Advisers Association of Australia (IFAAA) has sought to introduce a self-regulatory measure to the issue of independent advice. Advisers seeking membership of the IFAAA must comply with a strict set of criteria, known as the Gold Standard of Independence. This standard mirrors the Corporations Act requirements for independence, and in some cases even exceeds it.

Becoming independent means navigating these frameworks and understanding both the legal and ethical obligations that come with the term.

The legislation itself is complex but has two main prongs: freedom of ownership and a ban on commissions.

Freedom of ownership

On first glance, the Corporations Act requirements for independence of ownership are straightforward – no ties to product manufacturers and no restrictions on product. But closer examination reveals a far more complex landscape.

The question is how independent is independent enough?

Who's in charge?

Ownership by product providers is a recurring theme in section 923A, referenced in multiple clauses as a potential issue. While the language in the Corporations Act can be convoluted, the criteria boils down to a single question, according to lawyer Claire Wivell Plater from The Fold Legal – does the adviser's relationship with a product provider influence their advice?

Where a practice is licensed or a majority owned by a product provider, Ms Wivell Plater suggests the adviser would almost always fail this test.

"To be honest, it would be almost impossible for a business which was owned by, or where there was a substantial holding by a product provider, to pass that criteria," she says.

"In my experience, the influences are there even where they say they don't influence. There are a lot of ways that influence can be exerted even when it's not overt."

If an institution has a minority ownership over a practice, that adviser may be able to call themselves independent but would need to clearly show that this ownership had no impact on their advice – a tough hurdle to overcome, Ms Wivell Plater says.

But even being attached to a non-aligned licensee may not be sufficient, depending on your reading of the act. Daniel Brammall, founder of the IFAAA, takes a "one bad apple spoils the bunch" philosophy. In his view, and under the IFAAA membership criteria, an adviser cannot call themselves independent if any authorised representative within the dealer group accepts a benefit or commission from a product provider.

"As advisers, if our dealer or AFSL allows any other rep to accept those conflicted forms of remuneration, then we ourselves have access to it. We may not choose to get it but we do not satisfy section 923A for that reason," he says.

"The idea is to align yourself with an AFSL that is actually genuinely independent."

Alternatively, Ms Wivell Plater believes an adviser operating under a licensee that allows other advisers to receive benefits would be in the clear, provided they refused to receive anything themselves.

"The licensee or corporate authorised rep can receive other forms of services but they can't pass them on to the adviser and they can't be allowed to influence the advice their adviser gives," she says.

When adviser Corin Jacka, managing director of Corin Jacka Financial Solutions, decided to explore independence, he initially sought to join a non-aligned dealer group. But the models he found failed to meet his ideal of unbiased advice, with many licensees offering company badge products or preferred suppliers.

"I had to get my own licence, because there were very few licences out there that really had a true independent model," he says. "Even though [there are] a few independently owned licences out there, a lot of them have quite tight arrangements with product manufacturers."

For advisers who want to take out their own licence, ASIC provides guidance on their website. Many advisers who have taken this step – including Trent Alexander, director of Financial Planning Expert and IFAAA member – report that it is difficult but ultimately worthwhile.

"I just told myself, you only have to do it once. The benefit, however, was I could set all that up the way I wanted to," Mr Alexander says.

What can you recommend?

Even where an adviser operates under a non-aligned AFSL, they must ensure their product advice remains unrestricted. Ms Wivell Plater believes this ban is far-reaching – any prohibitions or incentives that might push an adviser in a certain product's direction would rule out independence.

"No restricted product list would be allowed, no direction or even suggestion that the adviser should prefer that product to another product," she says.

In recent years, technology has further complicated this question. If an adviser uses a wrap from a product provider, are they limiting the products they can recommend?

In Mr Brammall's view, independent advisers can generally use wraps or platforms provided they are not bound to one particular option. In his own firm, he holds authorities with around 20 different product platforms and offers clients a choice.

Ms Wivell Plater suggests this approach is in line with ASIC's regulatory guides. Yet in her experience, even advisers with multiple wraps on offer tend to default to using the easiest option.

"It's a tricky one because ASIC seems to have this expectation that advisers will offer their clients a choice of wraps and that it's an even playing field. Whereas my experience is that advisers generally have one preferred platform and they choose that platform, not because of the money it gives them, but because of their preference in relation to functionality," she says.

She suggests advisers can discharge their duty towards the client by justifying the use of a particular platform. Whether this would impact on their 'independence' would depend on the circumstances, she adds.

Another issue may arise where certain platforms offer clients a discount, Mr Brammall believes. While clients benefit from paying a smaller amount, it may limit the adviser's perceived freedom in some cases, he warns.

"If we're saying the main issue in relation to choosing a platform is cost, then there is no conflict between me having a discount offered by a platform provider and me advising on that platform," he says.

"The conflict does come up where I have some sort of incentive that is in my interests to recommend the platform, not in the client's interests."

This is particularly true if the size of the discount is contingent on how many clients sign up for that service, according to Mr Brammall.

"It can be a slippery slope," he warns.

IFAAA GOLD STANDARD OF INDEPENDENCE

The Independent Financial Advisers Association of Australia is an industry body that aims to promote "independent" advice. To gain membership to the organisation, advisers must meet the organisation's "gold standard", meaning:

1. **No ownership links or affiliations with product manufacturers**
2. **No commissions or incentive payments from product manufacturers**
3. **No asset-based fees**

This criteria mirrors, and in some respects exceeds, the requirements set out in the *Corporations Act 2001*.

Source: IFAAA website

> **"I KNOW OTHERS HAVE TRIED TO SUGGEST ASSET FEES DON'T GET CAUGHT BY THAT LEGISLATION BUT THEY ABSOLUTELY DO. THEY DECIDE TO TEST ASIC AT THEIR OWN PERIL"**
>
> Daniel Brammall, president, IFAAA

Other relationships

Advisers who operate under their own licence, have no ownership stakes from banks or insurers and offer a choice of wraps may believe they are operating 100 per cent "independently". Yet other relationship ties could also chip away at their credentials.

Aside from direct ownership arrangements, licensees frequently strike other deals with product providers for the provision of benefits or services, Ms Wivell Plater says.

As an example, she points to complying remuneration arrangements. While this type of extraneous arrangement might not always create conflict if the benefits are not passed on the adviser, the onus is on the adviser to prove they are not being influenced, Ms Wivell Plater says.

"You still have to demonstrate that you have arrangements in place to ensure that whatever those benefits are, they don't influence the advice you give, even if they are not passed on," she says.

Another type of relationship that may influence advisers is the human connection. Gifts and benefits from a product issuer are specifically outlawed in the legislation but goodwill can also have an influence. Michael Radalj, director of Eclipse Financial Group and IFAAA member, avoids any type of personal contact that might impact on his decision to choose a certain product.

"I don't want to feel obliged because I've sat next to someone on a yacht for an afternoon to have to go and recommend their product," he says.

Mr Brammall does not take such an extreme position but warns that personal relationships can become difficult to manage. While he does not believe a social connection automatically creates a conflict, he suggests in some circumstances it might become difficult to separate the personal from the professional.

"If I had a mate who owned the local NAB and my mate expected me to place product with NAB because of that relationship, then I would have to tell you the relationship has cancer. By doing that, by agreeing to that unspoken expectation, I'm compromising my professionalism and I'm really no longer independent," he says.

He points back to the guiding principle in the legislation – does the relationship have influence over the advice provided? As an example, he believes taking out a business loan with a major bank would be unlikely to give rise to problems.

"In the example of a loan, the evidence of the relationship is the existence of a product. I would have thought the evidence of a relationship would not be a product but a role in the organisation, a directorship or a shareholding of the parent company," he says.

Similarly, an adviser with a small shareholding in a major organisation like BHP would need to be aware of the potential for conflict, but would not necessarily be conflicted by advising on BHP shares, he suggests. Mr Brammall believes where the legislation is silent, individual advisers must make decisions on their ethical obligations.

"I think this is where you need to exercise some professional judgement," he says.

Eliminating commissions

Since the introduction of FOFA, commissions have been discarded in the industry, with the exception of risk and grandfathered commissions. Under the Corporations Act, advisers are banned from using the 'independence' label if they accept commissions of any kind, lawyer and partner at Minter Ellison Richard Batten says.

Where advisers have an existing client book but are moving towards independence, grandfathered commissions may be a sticking point, Mr Batten warns. In addition, even after an adviser has reformed their practice, new clients may come along with existing policies that include commissions.

In these circumstances, advisers may choose to rebate any commissions they are continuing to receive directly to the client, a move which is explicitly allowed within section 923A. Director of Roskow Independent Advisory and IFAAA member Neil Salkow says while rebating can mean additional administration, it allows clients to stay in products they are satisfied with.

"If clients have existing insurances in place and they find they're adequate,

we become the adviser of the policy and then it's a back-office administration nightmare to rebate those commissions," he says. "I say nightmare but once you have the process in place, it's actually quite straightforward."

However, Ms Wivell Plater warns rebating is not always endorsed by insurance companies.

"Some insurers don't permit it, that's part of the problem. The advisers then have to not deal with insurers that don't enable them to rebate the commission," she says.

Weaning yourself off

With new risk policies, advisers can choose to continue rebating commissions or write the commission out of the policy from the start, business consultant and Elixir Consulting managing director Sue Viskovic suggests. Where advisers create the policy with nil commission, insurance companies often offer a discount to the client, sometimes up to 30 per cent, she says.

However, if advisers are not receiving a commission for their work, they need to find another way to be paid. Generally, this takes the form of charging a fee for sourcing the insurance – a tactic many advisers are reluctant to pursue, Ms Viskovic says.

"Advisers who specialise in risk advice only, a lot of them immediately say 'You can't have fees for risk, clients won't pay it'," she says.

Yet her evidence suggests clients are willing to pay if the adviser justifies the amount – her firm's research shows 20 per cent of risk specialists have a fee-based model. In many cases, the discount on the policy may offset the fee paid by the client, she suggests.

The challenge is setting the fee at a level that rewards the adviser's time but is palatable for the client. Ms Viskovic says the average amount charged for risk coverage is $2,039. However, her research suggests the minimum to cover costs would normally be around $2,500.

"It's either those advisers [charging less] are particularly efficient or they haven't undertaken the process and they don't know that it costs a lot more than that," she suggests.

One danger with a fee model is the adviser may carry out the work, only for the policy to be rejected, Ms Viskovic warns. Either the client pays a fee but remains uninsured or the adviser works for no return.

"The way to prevent that from happening is to build into your process a pre-underwriting step that will uncover any really obvious health issues," she says.

"They can even pre-check with the insurance company to see the likelihood of the claim proceeding before they even go through the rest of the process."

Advisers who have embraced this model have not necessarily seen their bottom lines suffer. Mr Radalj described the decision to give up commissions as a "sacrifice" but says clients seek him out for his transparency.

"A lot of people are, for example, over-insured for life insurance but don't have cover for trauma. I can say to a client that 'You really should have this cover' and they know that I'm not getting an extra dollar from that," he says.

"There's a higher chance they'll take up that cover and be better off if circumstances turn against them."

Ms Viskovic says if advisers put in the time to properly research pricing and set fees at the correct level, revenue should not be affected.

"If they do it well, they don't need to see any decrease at all," she says.

Nonetheless, some advisers aspiring to an independent model may choose to outsource insurance and avoid the question of risk commissions altogether. IFAAA adviser and Roskow Independent Advisory director Matthew Ross would only offer insurance in the context of an extended relationship with a client. Unless they commit to an ongoing retainer, he refers them on to a specialist.

After negative experiences with risk insurance in the past, Rise Financial director and IFAAA member Phil Thompson now refers on all his risk clients to a broker.

"I had three cases in a row where all the work and effort went into it and the client didn't get underwritten in the end. I'm happy to now outsource the work to a broker and let them charge a commission on that," he says.

"I HAD TO GET MY OWN LICENCE, BECAUSE THERE WERE VERY FEW LICENCES OUT THERE THAT REALLY HAD A TRUE INDEPENDENT MODEL"

Corin Jacka, director, Corin Jacka Financial Solutions

Charging what you're worth

Once an adviser makes the decision to rid their practice of commissions and other benefits, the next question is how to stay viable. Getting pricing models right can be the difference between a successful independent advisory and a business that shuts its doors.

Legally questionable

The Corporations Act has over 1,500 sections yet there are still gaps as to how some laws should be implemented. One gap exists around asset-based fees in section 923A.

Mr Brammall sees asset-based fees as explicitly outlawed by the legislation, pointing to subsection 2(a)(ii) as his justification. When advisers use wraps, he argues, they are placing business with a product and charging the client based on the volume. His position – and the position of the IFAAA – is that asset-based fees are not allowed for advisers who use the 'independent' label.

"I know others have tried to suggest asset fees don't get caught by that legislation but they absolutely do. They decide to test ASIC at their own peril," he says.

Mr Batten disagrees with this reading, suggesting that particular clause should be read as a ban on commissions from product issuers. However, he believes asset-based fees could be seen as conflicted remuneration and raises a concern that these fees are not explicitly condoned by the section.

"I wouldn't want to be definitive but I would say there is a risk there," he says.

"Certainly, there seems to be an inconsistency in what is permitted under the conflicted remuneration regime and what is permitted under the independence regime."

Conversely, Ms Wivell Plater believes nothing in the legislation prevents an independent adviser from charging an asset-based fee. Nonetheless, she agrees with both Mr Brammall and Mr Batten that such fees could raise a conflict of interest that would be ethically, if not legally, problematic.

"It could be, for example, that the best interests of the client would be to pay down debt rather than invest," she says.

"So if the adviser recommends they invest, where they are going to get paid a fee, rather than pay down debt where they're not, then that would not be in the client's best interests."

Alternative models

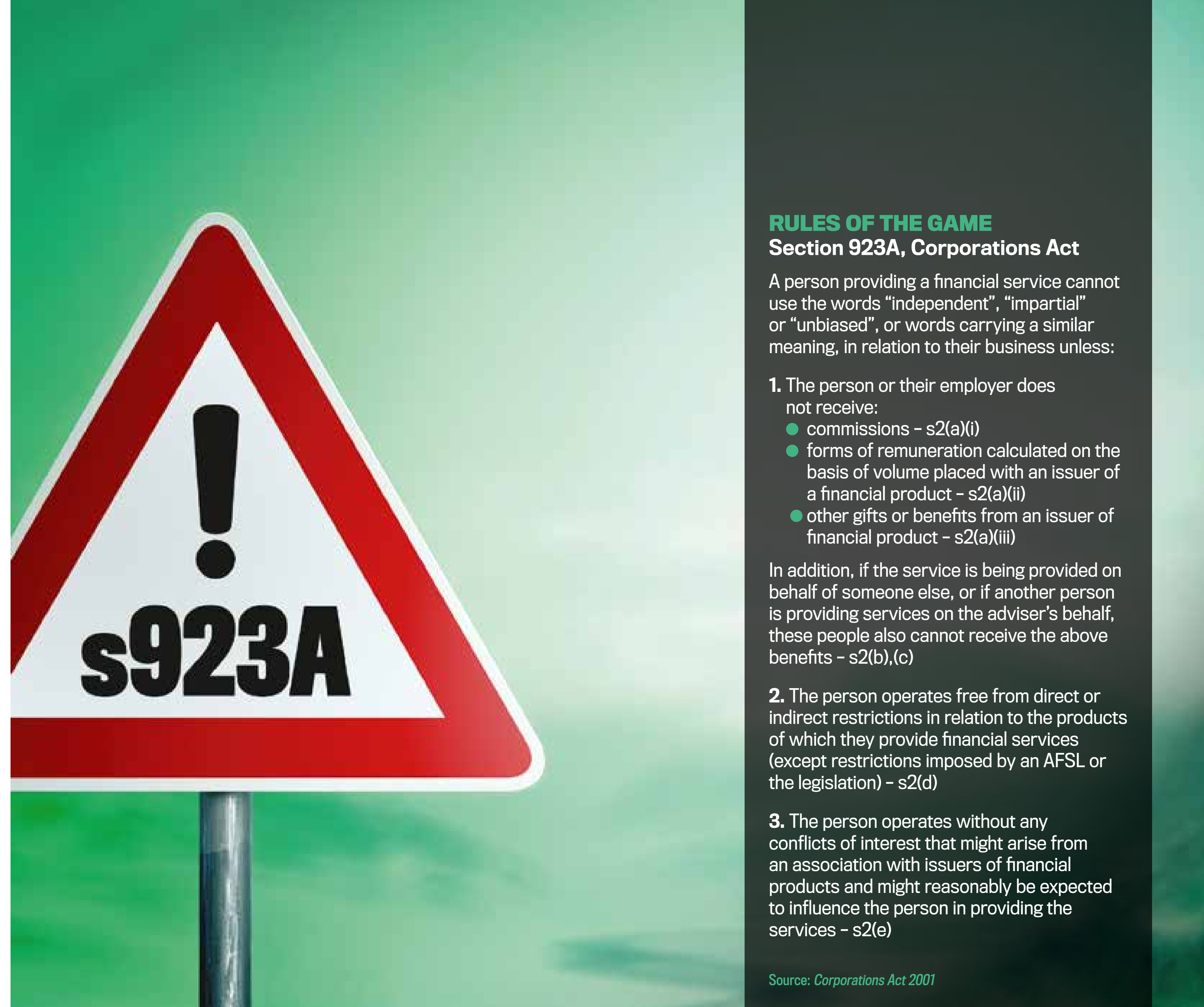
A substantial portion of the industry currently charges on the basis of assets held by a client – Mr Brammall estimates up to 80 per cent of advisers price their services in this way. Yet some advisers are breaking new ground and exploring innovative pricing approaches.

For starters, Etiam business consultant and pricing expert Martin Mulcare has advice on what not to do – charge by the hour. He believes hourly models reward inefficiency and stifle business growth.

"What kind of business do you want to create where the only way to get more revenue is to get more hours? That doesn't work for me," he says.

Ms Viskovic agrees, encouraging advisers to only charge hourly rates for project work or one-offs. She believes clients prefer knowing how much they are going to pay upfront and are less likely to have an open discussion with their adviser if they are getting billed per minute.

Instead, both Ms Viskovic and Mr Mulcare propose a flat-fee model or retainer. Under this approach, clients are charged a set amount based on how complex their circumstances are. This minimises the potential for conflict and shifts the emphasis to an adviser's service, rather than investment management skills, Ms Viskovic believes.



RULES OF THE GAME

Section 923A, Corporations Act

A person providing a financial service cannot use the words "independent", "impartial" or "unbiased", or words carrying a similar meaning, in relation to their business unless:

1. The person or their employer does not receive:
- commissions – s2(a)(i)
- forms of remuneration calculated on the basis of volume placed with an issuer of a financial product – s2(a)(ii)
- other gifts or benefits from an issuer of financial product – s2(a)(iii)

In addition, if the service is being provided on behalf of someone else, or if another person is providing services on the adviser's behalf, these people also cannot receive the above benefits – s2(b),(c)

2. The person operates free from direct or indirect restrictions in relation to the products of which they provide financial services (except restrictions imposed by an AFSL or the legislation) – s2(d)

3. The person operates without any conflicts of interest that might arise from an association with issuers of financial products and might reasonably be expected to influence the person in providing the services – s2(e)

Source: *Corporations Act 2001*

Setting your price

To calculate this fee, Mr Mulcare suggests a top-down approach. First, practices identify their target revenue and their target number of clients in each market segment, like retirees or small business owners.

Then they work out how much they would need to charge each type of client to achieve their desired income.

"The advantage of coming from this direction is it is linked to revenue," Mr Mulcare says.

Advisers can then add a layer of complexity by adjusting the price for more difficult cases, or even on the basis of the "pain in the ass" factor. It may even be helpful to have a "pricing committee" to make decisions on pricing, he suggests.

Ms Viskovic, on the other hand, suggests approaching pricing from the bottom up. She recommends breaking down how long it takes and how much it costs to provide each service, then charging a minimum fee to clients on that basis.

Ms Viskovic emphasises that choosing a pricing strategy is a work in progress. However, she firmly believes that flat fees give practices a competitive edge.

"I can definitely say that advisers who have shifted their business onto a flat-fee model, there is very little loss of clients," she says.

"It puts advisers in a much more robust position to be able to make business decisions because their revenue is not going to be at the mercy of the market, outside of their control. They can make longer-term decisions about their business and the infrastructure and how they're going to invest their profit."

Embracing changes

A move to independence means rebuilding your practice from the ground up, on a foundation of transparency and impartiality. While this is a substantial undertaking, Ms Viskovic believes advisers can profit from taking on the challenge.

"If the adviser chooses to make the move, it may not necessarily be easy. But if they're doing it for the right reasons and they're committed to the change, it can be an incredibly positive experience for the business," she says.

For advisers interested in independence, the legislation gives a roadmap for how to move forwards. But equally relevant is the experience of taking the journey – the unexpected twists and roadblocks, and the challenges that may confront you just over the horizon. ●