

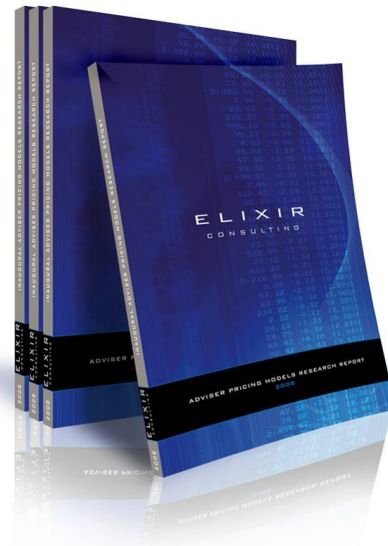
ADVISER PRICING MODEL RESEARCH 2008

Adviser remuneration is currently one of the most controversial and widely discussed aspects of financial planning in Australia. There are a wide variety of methods in which consumers can pay for advice and currently advisers are free to set their own pricing models as to what — and how they are paid (as well they should be). This freedom of enterprise affords the ability to structure an advice offering around the client base and expertise of each advice firm.

In real terms however, the industry is still relatively young in its evolution from advisers being price-takers to gaining more control over their business and revenue streams. Many advisers are keen to change the way they are remunerated, but either don't know where to start, or aren't sure how to overcome obstacles as they reach them.

As consultants in practice development we work with advice firms around the country, and regularly assist advisers through the process of changing their business structures and pricing models. To date, there has been little in the way of *qualitative* research into what pricing models are actually being used by advisers in Australia, and how advisers are remunerated for their advice and services. It is for this reason that the concept of the Elixir Consulting Adviser Pricing Models Research was borne. Over the past twelve months we have sought out firms around Australia who have actively addressed their remuneration structures and taken control of the way they charge for their services. The views and experiences documented in this research were collated from extensive discussions conducted with over 120 Financial Advice firms, spanning large and small licensees and representative of each state in Australia. There are a variety of challenges advisers face when setting their pricing models, and this research was created with a view to assist advisers in the process of remodelling their pricing structures, to learn from their peers about what is working in practice, and allow them to consider various alternatives and solutions.

It is difficult to get the level of candour required from advisers, to obtain enough information to form a thorough understanding of a pricing model. Businesses agreed to participate in this research on the grounds that their identity would be kept confidential. Each business featured has entered into a legally binding confidentiality agreement with Elixir Consulting that ensures their identity will not be disclosed at any time, to any party.



The full research report spans some 80 pages and will be available from a number of institutions over the coming months. This article is a small excerpt of the information contained in the research report.

The debate continues to rage about fees vs commissions as a method of remunerating financial advisers, and it is not the intention of this paper to prescribe or promote either model. If anything, our research confirms that there is no single ideal method of charging, rather a range of models that are as unique as the personalities in the businesses and the clients they cater to.

In fact, there are almost as many different definitions of 'fee for service' as there are pricing models in the market. The purist definition is that a fee is a set dollar figure charged to a client by way of an invoice that is paid by cheque or direct debit, and is completely unrelated to product.

Others define a fee as a figure that is derived by the adviser (not the product provider) for the advice provided, and can be expressed as a percentage of assets under management. The percentage figure is the same, regardless of what platform or investments are in the portfolio.

Most pricing models fall roughly into three categories:

- The Purist Fee Model — set dollar fees charged and invoiced, with all commissions dialled down to zero or rebated.
- The Hybrid Model — set fees charged for some aspects of advice, and commission received for others (eg, set fees charged for initial and ongoing investment advice, and commission received for risk, agribusiness and/or structured products)
- Pure Commission Model — advisers receive commission from product providers to pay for the advice provided to the client. There is still some adviser discretion in the amount received, for example, many managed fund investments and platforms allow the adviser to select the up-front fee to be received — from 0 to 5.5%.

Whilst there has been — and will continue to be — ongoing debate about fees vs commissions, the underlying argument is centred around transparency and fairness to the client, and above all, to ensure that advice is always centred around what is best for the client, not what provides a higher income to the adviser.

All too often people confuse the method of collection with the definition of a fee. Ultimately, whether a client pays their advisers fee by way of their cheque book, or from their investment earnings is a separate issue to how much the client is paying for their advice.

Content

The *Business Models* section of this research details 15 different pricing models utilised in 19 different financial planning offices around Australia — across 5 States (7 offices in city locations, 9 in suburbs, 3 in regional areas), and 15 Dealer Groups, (5 boutique, 1 small, 5 medium and 4 large).

The *Cost of Advice* section provides three sample clients, and the fees that they would pay for advice at each of the businesses featured; to demonstrate the practical outcome of each of the models detailed.

The report documents *Key Findings*, *Emerging Trends* and *Challenges* experienced by advisers around the country.

This research is not designed to be a broad quantitative study on trends across the whole industry; rather it is an in-depth, qualitative look at how advisers structure their advice. The research is also not designed to create a standardised method of pricing — if anything it demonstrates that this would be inappropriate. For example, in the *Cost of Advice* section, Sample Client Three would pay the lowest fees for advice at Company 14, and yet that Company is the second most expensive option for Sample Client Two.

The research paper documents 14 Key Findings, three of which are summarised below:

Up-front fees

Most advisers charge some type of initial or upfront advice fee. Typically referred to as plan and/or implementation fees; they are usually charged in order to recover some or all of the cost of providing that advice. It should be no surprise that the cost of providing compliant, comprehensive advice can be considerable.

Perhaps more important than simply covering costs, initial fees often have the affect of engaging the client and getting them to 'buy into' the process emotionally, which usually means that they place a greater value on the advice they receive, and take greater care to act upon the advice.

However, many advisers are challenged by finding the 'sweet spot' — how to charge a fee that is not so large as to frighten clients away, but is not so small as to create the perception that the advice is not valuable. As one adviser put it, "*our profitability lies in our ability to implement our advice for our clients, and if no-one proceeded, we would soon go out of business.*"

Hence, advisers who have a very well defined ideal client find it easier to price their services according to the client base they attract.

Range for initial and ongoing fees

Of the advice firms researched, initial fees for Comprehensive Advice range from \$2,000 to \$25,000+, or if an asset-based fee is charged, 0.5% to 3%. Initial fees for Limited Scope of Advice range from \$500 to \$2,250. (GST exclusive)

Ongoing fees range from \$1,200 to \$15,000+ pa, or if an asset-based fee is charged, 0.5% to 1% pa.

Rather than charging clients on an hourly rate after completing work for them, most advisers charge for their services on a 'job rate', which is usually quoted prior to commencing the work. Many advisers have estimated the time it takes to complete any particular task for a client, and worked their minimum/standard fees accordingly. The hourly rates used internally to create the 'job rates' range between \$250 and \$390 for adviser time, although the figure most commonly used is around \$280 to \$300. Administration time is usually accounted for at \$80 - \$100 per hour (net of GST).

It is insufficient to look at these 'headline fees' in isolation as businesses deal differently with income paid from products — not only from platforms and retail accounts, but also risk, agribusiness, structured products, margin lending etc. The only way to get a true understanding of what revenue a client will generate for an adviser is to look at their total business model.

So too, it is insufficient to look at these 'headline fees' to get an understanding of the cost of advice to a client. As demonstrated in the *Business Models* section of the research, a higher adviser fee may be charged by an adviser who rebates commissions on products, and therefore their clients may receive reduced rates on admin platforms, insurance premiums, investment products, loan facilities, etc.

Quality of advice

With the debate surrounding the correlation between adviser remuneration and professionalism, one might wonder if the pricing model of a business does, in fact, impact upon the quality of advice provided to their clients. Ultimately the issue of professionalism can be demonstrated by whether advice is always provided in the client's best interests; and whether if an adviser is being remunerated, then the client is receiving sufficient value for that remuneration.

Whilst the research did not extend to analysing technical advice provided to clients, it did reveal that those businesses who have engaged in a process of defining their pricing structure do appear to have improved their business models so as to improve the delivery of advice to their clients, regardless of whether they have arrived at a strict 'fee for service', commission or hybrid model.

Typically, advisers who have taken the time to design their fee structure seem to be more diligent about gaining efficiencies in their business, utilising standard procedures, effective software solutions, etc so they can maximise their profit margin and face-to-face time with their clients, and ensure that their clients do, in fact, receive meaningful ongoing reviews. There appears to be little variance in this area between those who choose to apply a percentage-based ongoing fee, or a flat dollar fee.

The advisers featured in this report who receive trail commissions for investments have all quoted a range of trail rates (typically 0.4% - 0.6%), as they use a variety of platforms and place clients in the one which suits their particular needs rather than the one that pays the adviser the greatest trail.

There are six *Emerging Trends* documented in the research, one of which being:

Better advice for Wealth Creators

Historically, advisers have been paid upfront and ongoing revenue streams calculated as a percentage of funds under advice. Not surprisingly, most advisers have built their business around the sought-after retiree market, where clients arrive with an asset base they have already accumulated, and require assistance throughout their retirement. In the past, the 'wealth creator' who has not yet amassed much in the form of savings has been poorly serviced by an industry that could not make money from a client who had none to start with.

With the evolution of fee-based pricing models, more advisers are finding they can build a profitable business by attracting and servicing younger clients, and there are now many more opportunities for the wealth creator to obtain quality financial advice.

Typically, this style of client requires assistance with budgeting, savings strategies, cash flow modelling, gearing strategies, risk insurance, estate planning etc, so the best advisers in this space utilise a specialised set of software tools and product suites to adequately service the wealth creator client.

The advisers who specialise in this market are more likely to provide better advice as they consider a greater scope of outcomes/possibilities for the client, i.e. if they don't write risk insurance, they may not recognise that the client has a need for it. If they don't have an ability to address mortgages, they may not review the clients' lending structure and products, and the client could be paying too much interest and/or tax.

Of the eleven *Challenges* that were common among advisers, we are often asked how advisers handle:

Moving old clients onto a new pricing structure

It is one thing to create a new method of pricing for new clients, but converting existing clients onto a new model is a separate issue. Most advisers found that they had a mixture of results with their new structure, with some clients paying the same or less for their services, which only worked on a business level if they were able to keep the clients who ended up paying more on the new structure. There are a variety of methods employed around the industry, including:

1. Draw a line between old business and new business. Leave the 'old business' clients on their existing fee structure and only introduce the new structure to 'new business' clients. Ultimately advisers find they are in a better position to make a decision on what to do with their 'old business' clients once they have implemented their new pricing structure and developed their comfort and commitment to it.
2. At each client review, present the new pricing model and get the client to change over to it. This method works best when the old model did not have detailed services, as it is difficult to ask for more money for the same service. At review, the adviser takes the client through a documented list of the services being provided and clearly enunciates the value that the client will receive for the fee paid. Most advisers also provide a Service Level Agreement which is signed at this time.

These methods work when the clients come in for a face-to-face meeting, but there is also the 'tail end' of a client base – those who are paying so little (usually in trail) that they don't come in for regular reviews. Again, there are a number of different options used; our research reveals five different techniques that work for various advisers.

In conclusion, advisers who are looking to review their own pricing model should obtain great assistance from the information gathered in this research. We suggest that when reviewing your own pricing model, ask yourself:

- Is my remuneration clearly disclosed to — and understood by — my client?
- Do I have a value proposition that goes beyond how I charge for my services? (as a method of charging is NOT a value proposition)
- Do I provide an actual service commensurate with the remuneration that I receive? i.e. rather than receiving ongoing revenue for a client who receives nothing in return.
- Is my model designed in such a way that it does not encourage me to recommend inferior/inappropriate products?
- Does my model allow me to service my clients in a profitable and palatable manner?
- Am I confident that my clients receive value for money?

When you can check all these boxes, you are on your way to having the right pricing model for your client base.

The Elixir Consulting Adviser Pricing Models Research Report is not currently available for retail purchase, but will be available from a variety of Institutions. Author and Managing Director of Elixir Consulting, Sue Viskovic is available for presentations at conferences and for consultation on the information contained in this report.

Further enquiries should be directed to info@elixirconsulting.com.au.