

**From:** Paul Little  
**Sent:** Friday, October 15, 2010 10:40 AM  
**To:** [sub@apesb.org.au](mailto:sub@apesb.org.au)  
**Subject:** Comment on APES 230 Financial Advisory Services

I am writing to comment on APES 230 Financial Advisory Services, specifically the impact of paragraphs 2 and 9.1 regarding "Fee for Service" that have the combined affect of preventing members from charging for Financial Advisory Services using percentage based asset fees.

#### My Background

I began my career as a chartered accountant and have been a CPA for nearly 20 years. For around 15 years I have specialized in financial advice, and have run my own practice (with Public practice membership) since 2003. This practice since its inception has operated on a fee for service basis – i.e. we have never received commissions for any investment or superannuation related advice and have always charged fees for both initial and ongoing services provided. During that period we have won several awards for the quality of our advice (refer below) and I regularly present on behalf of CPA to other practitioners on superannuation and relate tax matters.

During my years as an adviser I have seen and supported many positive changes to the financial advice profession – from FSR, through to the more recent Bowen Future of Financial Advice Reforms. I am not averse to change and am supportive of any reforms that will improve the profession.

I provide this brief background to illustrate my credentials as a "Professional" adviser – and in the hope that this submission is considered in this light and not dismissed as the views of a "product salesperson".

#### The Issue

I am vehemently against the proposal to mandate that professionals such as myself cannot charge our clients a fee based (either fully or partially) as a percentage of funds under advice. My objections to this proposal are for a number of reasons:

1. Philosophical

I object to the notion that APESB has a role in deciding what formula or basis we should use to calculate the fee for our client.

I mentioned before that we have always operated on a fee for service basis. For initial advice and implementation we determine a dollar fee reflecting the time, complexity and value of the work provided. For ongoing service, we generally charge either a minimum \$ annual retainer or a % of funds under advice – whichever is the greater. This model reflects my strong view that the definition of a fee is that it has the following three characteristics (i) it is fully transparent to the client (ii) it is agreed between the adviser and the client and not determined by some 3<sup>rd</sup> party such as a fund manager (iii) it can be terminated by the client at their discretion. Once these 3 features are in place, in my view, the manner in which the fee is calculated is irrelevant – the client is in full control of assessing (a) how much the advice will cost (b) whether they feel they are receiving value for money and (c) whether to continue or terminate the engagement at any time. My view is that the APESB proposal should be amended to define these three elements as the essential elements in the definition of "fee for service" and should absolutely not be dictating to individual practices how they calculate their fees.

2. What is a "Professional Fee Basis?"

I suspect that the definition of "Fee for Service" proposed is the result of a misguided notion that % based fees are somehow less professional than other methods of fee calculation. I strongly disagree with this notion for several reasons:

- (i) some argue there is the potential for conflicted advice with % based fees. My response to this is that there is the potential for conflict on any fee structure. For example – if I charge hourly based fees I am incentivised to either operate inefficiently or worse, spend more time on an issue than it deserves in order to increase my chargeable hours – and I have seen many examples of this over the years by both accountants and solicitors who charge by the hour. Similarly, if I charge a flat dollar fee to administer a self managed superannuation fund – it is not in my interest to suggest to the client that they would actually pay less and probably receive a better service by using a low cost industry superannuation fund – and indeed I have seen numerous examples of clients in self managed superannuation funds because their accountant has recommended it despite that the client has no interest in managing their own investments and where they are paying much more in fees and receiving worse service than other alternatives. No simple and transparent fee basis will ever be able to remove all potential conflicts. It is the job of professional advisers to manage these conflicts through their ethical behavior, transparency and delivering value for the fees they charge.
- (ii) we have on several occasions over the years surveyed our clients as to whether they would prefer us to use time based, flat dollar or % based fees – most recently in the past 2 years after the GFC. On every occasion the overwhelming response is that they prefer % based fees as they view it as a better alignment of our services with their desired outcomes. Put simply – if we help their wealth grow – we both benefit, if their wealth declines we both suffer. Whilst I acknowledge this is not a perfect alignment of interests (because many factors can contribute to wealth growing or falling) I would strongly argue it is a closer alignment than say hourly rates or flat \$\$ fees (and that is certainly what our clients have told us). I would ask how many of the proponents of this proposal have ever bothered to ask clients what they think?
- (iii) One of the fundamental differences between Financial Advisory Services and traditional tax and compliance accounting services is that the latter tend to be reactive in nature and the former proactive. For example, much of the work accountants generally do is reacting to things that clients must do due to legislation such as tax returns, BAS returns etc. Financial Advice on the other hand is fundamentally about getting clients to do things that they do not have to do – and have no lodgment deadline – but are significantly in their long term interest e.g. providing for retirement, having adequate insurance in place, putting wills and estate planning in place. I know from talking to many accountants that time or activity based fees are a major barrier to clients addressing “discretionary” (i.e. no fixed legislative deadline) advice needs. Put simply, when an accountant rings to suggest they do some work for the client on tax or estate planning the client often thinks “the clock has started ticking” and says “no” or “lets look at that later”. Retainer style fees (whether % or dollar based) are much conducive to a relationship where the adviser drives proactive decision making. Put simply – if a fee based adviser is not regularly seen by clients to be contacting them and suggesting ways to add value – they will simply not continue with the fee. The fact is that \$ or % based fees retainers help facilitate a much better, proactively based relationship between adviser and client than hourly or activity based fees and are much more suited to Financial Advisory Services for this reason.

### 3. Practical Problems

There are a number of practical problems with the proposal.

- (i) Some products (such as life insurance) can largely still only be placed using a commission style form of remuneration. Even if these commissions are rebated (which often cannot be effectively done) and the client is charged a fee instead – the client suffers because initial financial planning fees are not tax deductible whereas a commission that forms part of a tax deductible income protection or life insurance through superannuation policy – is in affect be tax deductible to the

client. The result of the proposed “fee for service” model would be to contribute to a massive fall in the degree of insurance advice provided to clients and an exacerbation of an already chronic and well documented underinsurance problem in Australia.

- (ii) The submission does not facilitate hybrid fee models. For example, for some clients we charge a flat annual retainer for our “strategic advice” and a % based fee for running their portfolio. This model is very well aligned to their interests in that the service of managing their portfolio is fundamentally about achieving good risk/return outcomes and is ideally suited to a % based fee whereas the strategic advice is set at a level based on the complexity of the client. I would find it hard to imagine anyone arguing that this is not an appropriate professional model – yet the proposal would ban such models.
- (iii) Current Federal Government policy under the Bowen Future of Financial Advice Reforms is that in addition to the full disclosure of financial planning fees that has been in place for years, that clients will need to “Opt in”, in writing, to agree to pay their fees each year. Given such a system that is so heavily weighted towards consumer protection and ensuring consumers only pay for advice they value – it is hard to imagine what extra benefit clients would receive by also having their advisers fee charging methodology dictated to them in this way.

### Concluding

In conclusion, I have tried to keep my comments succinct and constructive. I am the last person to prosecute sensationalist or overblown rhetoric. But having been a professional adviser and CPA for around 20 years, were this proposal to be adopted, I would see no other course than having to resign personally and as a business from the CPA for both philosophical and practical reasons – and I would expect many other professional advisers would do the same. This is thoroughly misguided proposal and should be dropped immediately.

I would be pleased to discuss these comments further if desired.

Regards

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