



# Phasing Out Commissions – how to Change your Adviser Remuneration Structure

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Sue's finance career started in 1997 in the Perth banking sector before extending into financial services with a five year relocation to Sydney. Since then, Sue has been a financial adviser to private clients, and provided practice development support to financial planning businesses around Australia in various national roles with Challenger International, Bridges Financial Services, Prosperity Advisers and the Sentry Group/Epic Adviser Solutions.

A Certified Financial Planner™, Sue regularly presents at conferences and writes for industry publications, in addition to leading a successful team of advisers and executive coaches. In 2008 Sue was elected Chairperson for the West Australian chapter of the Financial Planning Association (FPA).

This paper is an extract from her book, 'Pricing Advice. Creating the right fee model for your financial planning business'.

**W**hether you like it or not, commission-based payments are being phased out of the financial advisory profession and every adviser who provides investment advice needs to create a pricing model. For some, it will be a totally foreign experience; for others it will simply be an opportunity to refine a fee model they have been slowly implementing over the past few years.

While most advisers have accepted their fate, many discover that they have more questions than answers when actually embarking upon the process of developing a new remuneration structure. In our experience, creating a pricing model for an advice practice can be a challenging, frustrating, time-consuming, but infinitely rewarding process.

This paper contains some insights that will help you in your pricing journey.

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## WHAT ABOUT RISK INSURANCE?

Commissions for providing advice on Risk Insurance remain separated from investment advice and, at the time of going to press, will remain an allowable form of remuneration. If you only advise on Risk then you may not be affected. However, there are numerous challenges ahead for practices that include Risk advice as part of a holistic financial planning package. We will also explore this issue later in this paper.

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## BACKGROUND TO PRICING MODEL RESEARCH

I started the Elixir Consulting Adviser Pricing Models research project and Pricing Advice Program in 2007. It may be prescient but, at the time, I did not know that commissions would be forced out in a few short years. Having worked with many financial planners around the country as a business coach, I discovered that many of their issues stemmed from the fact that they didn't price their services properly – simply: they didn't charge the right amount at the right stage in the advice process to adequately service their clients.

My experience told me that a robust pricing model was a powerful driver of growth and development in a business, and I was intent on developing a range of tools that would help make the process easier for advisers; to learn from the mistakes and triumphs that other advisers had experienced before them.

## WHAT BENEFITS ARE THERE IN CHANGING MY PRICING MODEL?

The right pricing model will see you regain control of your business, improve the quality of service provided to clients, and improve the profitability of your practice.

If you have only ever charged commissions or asset-based fees, you may be pleasantly surprised to learn that changing your pricing model may expose your business to new markets: clients that, in the past, were not able to access advice because you were unable to charge them appropriately.

## NEW CLIENT DEMOGRAPHICS

There is a range of burgeoning prospects who may have significant need or complexity but little in the way of assets. Consider the following sample client list to identify new demographics that may need your help to build up investment portfolios:

- Saskia: aged 40, earning significant income. Has paid off her home loan before seeking advice.
- Rhett: Has built a portfolio of investment properties before seeking advice. Might be prepared to diversify future investments but cynical about advisers who 'sell only managed funds'.
- Glenn: aged 30, has just taken a job working in the mines and is earning a six figure income for the first time in his life. Has seen his co-workers waste their money paying too much tax and buying plasma TVs. Prepared to pay for advice so he can save his earnings and have something to show for his hard work and time spent away from home.

There are also those who have significant assets and complexity, but the majority of their current investments are tied up in a defined benefit fund, or Industry Fund. While they are happy to stay in such funds, they still seek comprehensive advice.

Advisers talk about 'good clients' in terms of their level of assets, but we need to break the nexus between assets and fees. Clients with no savings arguably need your advice just as much, if not more, than clients who have amassed their savings already. How will they build their net wealth without you? The hard way. Of course, some will remain dubious of financial planners – they are immune to the value of advice, and won't be prepared to pay a fee for it, but there are many others who would dearly love to have a trusted adviser in their corner, helping them to define and achieve their financial and lifestyle goals. It becomes a matter of putting pricing into perspective: if consumers already outsource their cleaning or pay for a personal trainer to help them get into physical shape, why not pay a fee to a professional adviser to help get their financial life in order?

## THE CHALLENGES OF CHANGE

Since its evolution, the financial planning profession has ignored pricing as a business fundamental because our products and services have been priced for us. Fund managers and insurers have determined what prices we charge by the upfront and trail commission rates they set for their products.

Whilst it is common practice for other business owners to price their services, the challenges in a financial planning practice are quite unique for the following reasons:

### → *Advice is Intangible*

What advisers are selling is their intellectual property, and the outcomes they can help their clients to achieve. Clients are paying for an adviser's ability to:

- lead them to qualify their goals and objectives;
- analyse the clients' position and work out how to achieve those goals; and
- inspire clients to implement the advice to actually achieve these goals.

This is a process which is undertaken not just once, but over time. If advisers sold widgets, it would be easy to apply a margin to the wholesale price paid for the stock and be done with it.

### → *Clients Fail to Appreciate the Value of Advice*

Until they experience valuable advice first-hand, clients will only have a vague understanding (if any) of what financial advice entails and the importance it can have on their lives. This is a Catch-22 situation: clients need to pay for advice before they can truly understand its value. How do you create a pricing model that allows them to do this?

### → *Many Variables affecting Fee Payments*

#### → Pure Risk

For advisers who provide Risk Insurance advice, there are many variables that impact on the cost of providing advice to clients. Until recently, the argument about charging fees for insurance advice has been largely moot, as consumers had no choice in the payment system. Even if they paid their adviser a fee, they received no reduction in the premium for their policy; they would still pay the same premium amount even if they wrote the policy directly with the insurer (if that were possible). Advisers who wanted to rebate commission had to physically write a cheque out to their clients, after receiving the commission from the insurer, and this caused all sorts of problems with their dealer group deducting the dealer fee etc. Recent developments have allowed advisers to write some policies with the commission rebated, but only on a similar basis as their flat commission option. Even then, the entire cost of the commission is not always deducted from the cost of the premium.

→ Comprehensive Investment Advice (inclusive of Risk)

Advisers who include risk recommendations in addition to investment advice face some onerous decisions. Do they charge fees for some aspects of advice and take commission for others? Or try to determine the appropriate fee to charge to cover insurance advice? It is difficult to know how long it will take to assist any client through the underwriting process, and impossible to know if that client will need assistance with a claim during the life of the policy.

## MAINTAINING YOUR PRACTICE AS AN ATTRACTIVE BUSINESS PROPOSITION

The unique nature of financial planning means that many practices can be developed as an outstanding business opportunity for future buyers. There is no stock on hand, no need for warehousing premises, and there are not many other businesses that can essentially know who their clients are and what their likely revenue will be on 1 January every year.

There is a reason why advice businesses achieve sale prices of 2.5 to 3.5 times recurring revenue whereas other industries, such as accounting, are valued on a much lower scale. The traditional financial planning business achieves a great deal of leverage in its revenue. Trail commissions build up over time and are not necessarily linked to service or time output, so many advice practices can continue to grow their revenue without increasing their overheads.

It is critical that, when creating a pricing model to replace a 'trail book' or asset-based fee model, the value of your business is not reduced because this leverage in your income has been removed. You should be able to keep the leverage and also increase the service levels to your clients - thereby increasing client loyalty and new referrals.

## CREATING A PRICING MODEL

Changing one of the major fundamentals of your business can be a daunting prospect: where to start? Is there a tried and true pricing model that can be simply unwrapped and plugged in with minimal disruption to the business?

Unfortunately, it is not that simple. One of the overwhelming outcomes we discovered in our Adviser Pricing Models research is that there is no 'one-size-fits-all' pricing model that will suit all types of clients. Just as every client is different and has varied advice needs, so too is every business owner - what suits one business may not suit another. There are two key decisions that need to be made before developing a pricing model.

### 1. Define your Ideal Clientele and Value Proposition

If you are going to create a new pricing model, you need to be clear about the type of client you are servicing, otherwise you run the risk of creating a structure that is either too expensive, or generally unattractive to your target market.

You should either create a pricing model to suit the clients that you have, or change your pricing model to suit the clients that you want.

### 2. Define your Billing Structure

You need to decide how you will charge your clients. What are the possible models that could be used to price advice? Your options include:

- time-based billing - charging clients by the hour retrospectively;
- flat fees - charging clients an amount that is quoted in dollar terms, regardless of how much they will invest;
- asset-based fees - a percentage that is applied against the funds that you manage directly - usually via a wrap account, but may also be via retail funds; or
- a combination of both flat fees and asset-based.

## EXPLORING PAYMENT SYSTEMS

Advisers should select the model that is most appropriate for their business, and their clients. Each of the above options has its own benefits and shortcomings, and it is important to analyse these before arriving at the right fee model for your practice.

In reality, clients should be happy to pay whichever model you choose, as you will be able to 'sell it' to them based on the benefits and your own conviction in using that model. Therefore, it is most important that you make the decision that is right for you and your clients, rather than simply sticking with what feels most comfortable.

## CHARGING BY THE HOUR CAN BE BAD FOR BUSINESS

We believe that for the sake of the client, and for the sake of the business, time-based billing is not an appropriate charging model for financial advice. That is, the practice of charging clients for the amount of time it takes to complete their work on a retrospective basis.

From a business management sense, it is important to know the time and costs expended to deliver advice to clients in order to ensure that the fees charged at least cover costs. However, advisers should use this information as a guide only, and create a fee model around it.

To put it plainly, clients are impervious to how long it takes you to do something; they are looking for answers and outcomes. There are numerous arguments against charging for financial advice by the hour, some of which are summarised below.

- Time-based billing will discourage client contact. Your clients should feel comfortable that they can ask you a question, and clarify your advice without having to worry about getting billed if they want to discuss fears, or request more information.
- Time-based billing means that clients are billed after the event, when it is too late for them to make a decision as to whether they feel the amount is reasonable for the value they receive in return. When the focus is on a long-term relationship, why create the potential for disputes over the issue of fees when it is so easily avoidable?
- Time-based billing creates a significant administrative burden for a business. Assuming all advisers will be diligent about logging their entire day into time sheets, the practice will need to undertake a comprehensive billing process each month where hours are tallied, bills are collated, and then clients are invoiced (or accounts held in Work In Progress until the job is completed). Invoices are then created and sent out, and someone has to chase up the debtors. In most accounting firms, a Partner will view the time billed, and often write down work that seems excessive, leading most to question why they bothered keeping time sheets in the first place!
- Time-based billing in arrears means that accounts will vary from month to month, so an automated payment system cannot be established. Not only does this mean inconvenience for the client who may prefer a direct debit arrangement, but also further administrative time and cost.

## COLLECTION METHODS

Charging fees does not necessarily mean that your clients are invoiced and they make a payment manually out of their cashflow. The aim is to keep the collection method as painless as possible for both business and client. Most advisers are paid by their platform, and this is a simple system that suits both the client and the adviser.

There has been some confusion regarding the payment of fees via platform – is this a commission by another name? No. If you have decided upon the fee structure, the client has agreed to it, and it can be switched off by the client in the event he/she no longer wants you as an adviser, it is a fee. Just because it is administered by the platform does not make it a commission.

However, it is important to know what your platform(s) can manage in terms of administration. Some platforms allow you to select *only* a fixed dollar amount or a percentage of assets, whilst others offer both options simultaneously. It is worth exploring any platform limitations before creating an overly complicated pricing model that is unable to be administered.

Of course, you can also set up a direct debit facility from the clients' bank account (or their Self Managed Super Fund's (SMSF's) Cash Management Trust). While most licensees provide this facility, there are also a number of on-line providers that can administer this (Paypal, Ezidebit, Ezipay, etc).

## WHAT TO DO ABOUT EXISTING COMMISSIONS?

Advisers who currently handle other services that pay commissions, such as Risk Insurance and finance broking, need to decide how to incorporate these payments into a new pricing model. There are basically two options:

1. Receive the commissions – this may add to the value overlay discussed later in this paper; or
2. Rebate the commissions and replace them with a fee - but ensure that these services are included in your fee calculator.

Advisers should resist the temptation to take the commission, but then offset that against the fee that would have otherwise been charged for investment advice. Only do so if the additional work required for the insurance was included when calculating the fee.

If an adviser determines that a client should be charged, say, an Engagement Fee of \$3,500 while the adviser receives \$4,500 in insurance commission, it may be tempting to offset the Engagement Fee; after all, the sum received from the insurer is greater. However, to do so would be to take a gamble that the underwriting process is straightforward and that the client never needs to make a claim. A rarity! If the adviser accepts the insurance commission to cover fees to engage the client, then claims assistance may need to be provided free of charge some time down the track.

Before deciding how to incorporate commission payments in your pricing model, it is helpful to look at just what services an adviser is expected to provide in order to receive an insurance commission.

1. Helping clients to confront and address the risks they face (i.e. 'selling the concept' - if not for your advice, they may have never covered their family).
2. Determining the appropriate levels of cover and insurer for clients.
3. Assisting clients through the application and underwriting process.
4. Assisting clients (or their family) in the event that they need to make a claim.

Do not underestimate the importance of step four; when a client claims on insurance it is time-consuming and costly. Providing claims assistance is a vital component of an adviser's value proposition but one that (hopefully) clients may never experience, so it is difficult to ask them to pay a fee to cover this - and it is certainly distasteful to send them an invoice for services in their time of need (especially if the claim is declined).

There will be a threshold at which the commission represents profit, regardless of how complicated a claims process may be. This is the time to make a judgement call and perhaps offset some, or all, of the fee if the insurance commission exceeds a certain figure - this will be an amount at your determination. If the premium is particularly large and it is difficult to justify receipt of a large commission payment in the first year (to yourself and/or the client), another alternative is to take the level commission.

It is important to reiterate the subjective nature of determining a payment system. What seems right for one business is not for another. Our pricing research unearthed one adviser who is adamant that every client must pay at least \$1,500 for the adviser's Engagement Fee, regardless of how much other risk or finance commission is earned. The adviser's theory is that clients are more emotionally connected to the advice and take greater ownership if they feel that they have physically paid for at least part of it.

## HOW TO CALCULATE YOUR FEE

Before calculating fees, it is important to understand the real business cost of serving clients.

### ADDRESS ALL BUSINESS OVERHEADS

You need to get an understanding of your 'charge-out' rate for all staff who deliver advice:

- Starting with your business's Profit and Loss statement, look at all the expenses required to run the organisation effectively.
- Separate out your total employment costs of the staff who are directly involved in delivering advice to your clients (adviser, paraplanner, Client Service Manager).
- Determine your desired profit margin.
- Get a clear picture of the number of chargeable hours worked in your business (consider 'unchargeable hours' spent on breaks, personal development/training; conferences; etc).
- create a notional charge-out rate for each level of seniority.

While this paper does not recommend charging by the hour, it is vital to analyse the above to understand the minimum amount that staff should be generating to fund salaries and the other overheads of an advisory business. By using the costs of running

your business, applied against the chargeable hours of the staff and building in a profit margin, it is possible to at least determine a notional charge-out rate for advice staff and administration support.

Our research showed that, in 2008, the charge-out rates used to calculate fee models in Australian advisory practices ranged anywhere from \$250 to \$390 per hour for adviser time, but typically averaged around \$280 to \$300 (plus GST). The rate for support staff was \$80 to \$100 per hour.

## DETERMINE TOTAL TIME INVESTED IN NEW AND ONGOING CLIENTS

You also need to determine the average length of time it takes staff to bring on a new client, from the first phone call through to implementation. Finally, analyse your ongoing service packages to get a feel for the length of time required to provide ongoing advice to clients (recognise that this may vary across the demographics).

Apply the charge-out rates (as calculated above) against these average times to arrive at the minimum fees that should be charged for each service in your business. It is a minimum rate because it does not account for the complexities that may occur with any client, nor have we priced in the risk taken to run a business that provides financial advice.

## ADD THE VALUE OVERLAY

This is perhaps the most difficult part of the process, but extremely important. It is based on the concept that clients are impervious to the time it takes advisers to do their job; they only care about what value they receive and what outcomes they will achieve from financial advice.

There are a few ways to create a value overlay but, essentially, it will vary with each client. For some clients, you may choose not to add anything to your minimum fees; for others, you may add a premium to arrive at a higher total fee.

Consider the client, Joe Bloggs, for whom your advice will save \$20,000 in tax every year. You have encouraged him to save an additional \$5,000 per year than he has managed in the past and Joe is extremely grateful that he has a trusted adviser who assists him to manage his SMSF. If your minimum fee to deliver the ongoing level of service he desires is \$1,500 per annum, arguably Joe would be happy to pay more than this for the value he already receives.

If you have chosen to receive commissions from Risk Insurance, finance broking etc, this may go some way to providing a value overlay. If the underwriting process has been simple and you never need to assist a client with a claim, then you will enjoy a good profit. However, if the client needs to make a claim, then you may find that you earn every dollar of that commission and spend a large amount of time and emotional energy liaising between the insurer and the sick (or grieving) client.

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## IMPLEMENTATION STRATEGY: YOUR NEW FEE STRUCTURE

After designing the fee structure, the next step is to determine an implementation strategy. How will the proposed fees be communicated to new clients, and how will an existing client base be transitioned into a new fee structure?

There is no denying that this will generate challenging new conversations with clients. Businesses will need to have good marketing materials to help enunciate the value of their offering, and to make the intangible nature of financial advice somehow visible and demonstrable.

Advisers need to learn how to 'sell' their fees, and perhaps even re-learn how to sell their advice. The prospect of so much change can be overwhelming so it is wise to seek as much help as possible to become educated on the topic. Evidence from our pricing research showed that those advisers who sought external assistance achieved better, faster results during their transition to fee-based services. The objective advice of someone outside the business can be invaluable, as remuneration can be an emotional and/or sensitive issue. It can also be helpful to talk through the issues with a consultant who has experience with the pricing arrangements that are already working in the marketplace.

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## CONCLUSION

After the challenges of Financial Services Reform and the Global Financial Crisis, it may be tempting to view the transition to fee-based advice as yet another hurdle but, in reality, it can be an excellent opportunity.

Incorporating a workable fee model involves both process and practice. Advisers undertake a process to improve the likelihood of getting the numbers and structure right, but it will take some practice to learn a new way of doing business – particularly during delicate conversations with clients.

While it can appear daunting, undertaking the process to create a pricing model will ultimately be very beneficial for advisory businesses. Whilst it is a significant investment in time, it forces advisers to reflect on how they deliver advice and manage their entire business, which invariably leads to some degree of improvement. Most businesses achieve a significant return on this investment.