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# End of the road for trail commissions

Financial product fees face an overhaul following the release of the Ripoll report



**Simon Hoyle**

LATE last month, the chairman of a parliamentary joint committee inquiry into financial products and services, Labor MP Bernie Ripoll, tabled his long-awaited report.

The report recommended that all payments from the manufacturers of financial products to financial planners cease. The committee stopped short of recommending an outright ban on commissions, opting instead to “work with the industry” to figure out how best to stop them.

It was widely regarded as a missed opportunity to formally stamp out commissions once and for all.

So for the time being, at least, we’re relying on the industry taking its own steps to phase out commissions.

The Financial Planning Association of Australia wants planners to stop receiving payments from product manufacturers from July 1, 2012, at the latest. To help facilitate this move, new services are springing up.

One is the commission rebating service, which effectively converts a stream of commissions from product manufacturers into true fees paid to financial planners in return for adequate and appropriate service.

If you’ve invested money directly into a retail managed fund, or even if you’ve invested on the advice of a financial planner, you could be paying a considerable amount of commission each year without even knowing and without getting anything in return.

Each year, you pay a fee to have your money managed. That fee is deducted from your managed fund account and it

covers the fund manager’s costs (including investment management and administration). But it also includes a component that’s designed to pay financial planners for any ongoing service and advice they may give you.

This component is called a trail commission. It’s deducted from your account whether or not you invested via a financial planner and, even if you did invest via a financial planner, whether or not you receive ongoing service.

The reason fund managers charge a fee with a trail built into it, regardless of whether or not you’ve invested through a planner, is because they do not want to upset financial planners.

Financial planners are the main distributors of managed funds; if managers offered a lower-cost version of a fund directly to the public then they’d be undercutting their distributors.

Perhaps worst of all, those distributors then may have to explain and justify why it costs more to invest through them, and they may end up having to offer ongoing service in return.

The FPA wants planners to set explicit fees for the services and advice they provide; to negotiate the fee with their clients; and for the fees to be paid directly by the client to the planner, with no role played by the product manufacturers.

The aim is to put clients in control of the fees they pay and, crucially, to enable them to stop paying fees to planners who stop providing ongoing services (or switch payments to another planner if they choose).

Some planners already eschew commissions; others are moving to rejig how they’re paid before the FPA’s 2012

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deadline. Others still will wait until the last minute.

A trailing commission of 55 or 60 basis points a year — that is, 0.55 per cent to 0.6 per cent a year of the amount you have invested — can soon add up.

If you've got a couple of hundred thousand dollars invested across a range of funds and fund managers, trailing commission could be as much as \$1200 a year. That's \$1200 a year that fund managers are deducting from your accounts and that lines the pockets of a financial planner, who often does nothing for it, or goes into some kind of consolidated revenue account that the manager can use for a variety of purposes, many of which will be of no benefit to you at all.

You certainly should not be paying for something you're not getting.

And even if you do receive ongoing service and reviews from your financial planner, there's a bigger issue of whether commissions are a desirable feature of financial planning at all (more on that later).

MyMoney Australia director Graham Burnard says commission rebating services are all about putting investors back in control of who they pay, how much they pay and when they pay it.

"The fundamental issue we see is not so much the source, because the ultimate source is the client's account, as it is the control," Burnard says. "You

can end up with a situation where you have a fee for no service, 'orphan' or inactive clients still having costs coming out of their investments, paying for a service they are not getting."

With a commission rebating service, commissions are deducted from managed-fund accounts, but paid (after the rebating service has taken its cut) directly to the investor's bank account.

This creates a balance that can be applied towards paying an explicit advice fee charged by the planner.

Burnard says rebating services work most effectively for trailing commissions. Fee-for-service planners can "dial down" upfront commissions to zero, and the commission is generally rebated in the form of additional units in the managed fund. Commission rebating services also work for life insurance products, which generally pay higher commissions than investment-based products do.

Burnard says that in some cases, financial planners use a rebating service to rebate insurance commissions to clients, and the commission can be sufficient to cover the fee charged for the planner's services.

To reclaim trailing commission, it's necessary to appoint a commission reclaiming service such as MyMoney, or iRebate, as your adviser.

This is so they have the authority to direct the fund manager to pay trailing commissions to a bank account set up for you and which you control.

This is called a refund account or

something similar, depending on the service you use.

It's important to note that neither MyMoney nor iRebate, or any similar set-ups, offer financial planning services or advice; they are simply mechanisms by which investors may reclaim commissions that otherwise are lost to them.

There's a cost, of course.

Both services structure their fees in a similar way. Up to a certain threshold, commissions are split 50-50 between the service and the investor.

In the case of MyMoney, the first \$480 of commission is split (so MyMoney receives a maximum of \$240 a year); iRebate's financial services guide says the first \$790 is split (so iRebate receives a maximum fee of \$395 a year).

A calculator on the iRefund website shows that a \$250,000 investment in a managed fund, generating a return of 8 per cent a year and paying a 0.6 per cent a year trailing commission, can siphon more than \$18,700 from an investor's account during a 10-year period.

Burnard says rebating services achieve two things.

First, and foremost, they return to investors money that is arguably rightfully theirs anyway.

And, second, they fit into the fee-for-service pricing environment that financial planners are being encouraged to move into.

Simon Hoyle is editor of *Professional Planner* magazine.



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