What's the deal with financial planners?

■ Do you need an independent financial planner? How will you be charged and how will you pay? What can you expect for your money? **Margarete King** spoke to some of the industry's top people.

A MAN WALKS INTO A PUB. HE SITS DOWN at the counter and says to the barman: "I am getting a fantastic discount from my financial planner."

"So how much is the discount?" the barman asks.

"I'm paying him only one percent of what I invest," the man says.

"You do know that's the maximum you can be charged, don't you?" the barman replies.

This is not a joke. No really, it's not a joke. If you pay for the services of a financial planner, the expense won't be insignificant. You need to know exactly how much it is going to cost you and what you can expect to get for the money you pay. Just as important, you need to know *why* you see a planner, so that you can get the best value for your money.

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The Financial Planning Institute (FPI), the professional body of financial planners, says on its website (www.fpi.co.za) that a planner "works with you to review all your options so that you can make informed decisions about your financial situation at every stage in life". The intention is that you, working with a planner, are able to take control of your finances and achieve your life goals.

The FPI goes on to say that the best results come from working with a financial planning >>

>> professional accredited by the institute. The FPI awards the Certified Financial Planner (CFP) accreditation. This is recognised as the highest qualification for financial planners in the country.

The important thing is that you avoid a commission-only structure when using a planner. For decades, advisers have earned upfront commission and yearly fees from the policies and investment products they sold. A criticism levelled against the commission-only structure is that it is a perverse incentive to sell products to earn a living.

"You pay upfront commission on the expectation the adviser will look after you for the term of the policy," John Campbell, the co-founder of Chartered Wealth Solutions, says. "But does the adviser look after you while you keep paying? Or does he try to sell you another policy every time he sees you to make some more commission?"

John Campbell

Prem Govender

Craig Kiggen

Campbell, who began his career in the insurance industry and was named the Financial Planner of the Year in 2008, says this remuneration system can result in bad advice: "Commission is an incentive to sell products, not necessarily offer the best advice, and advisers can advise their clients incorrectly to maximise their earnings."

Since the signing into law in 2002 of the Financial Advisory and Intermediary Services (FAIS) Act, there has been a legal requirement that advisers and planners give you appropriate and fair advice, and put your interests ahead of their own.

"In the past, some people believed the financial services industry was the place to make a quick buck. We, as an industry, did not behave; regulation had to be put in place for us," says Prem Govender, a former chairperson of the FPI and now a board member of the Financial Planning Standards Board (FPSB), the international standards-setting body for financial planners. "It is the baggage we carry as an industry – the perception from the past that if you fail at everything else you sell insurance."

The commission model is still used by the majority of advisers, but it now shares the field with the fee-based model of remuneration. And professionalism is the foundation from which to continue expanding the fee-based model.

Craig Kiggen, an executive director of Consolidated Financial Planning and the Financial Planner of the Year in 2006, says: "The financial services industry is desperately trying to convert itself into a body of professional financial planners, which includes adopting a fee-based system rather than a commission-based system. The former is seen as the 'racehorse', the latter is seen as a 'donkey'."

For Kiggen, it's a "high-falutin' view" to expect a financial planning firm to charge fees only. "The reality is that a growing financial advice business is going to struggle to get cash flow going," he says.

He says the barriers to entry for an independent firm are high and conversion to a fee-based structure is very difficult.

Independent firms have dealt with the financial pressure in two ways: by adapting their fee structures and practice structures.

Fee structures

THE VAST MAJORITY OF INDEPENDENT firms have mixed remuneration structures.

Govender says an FPI survey shows there are very few purely fee-based CFP professionals who invoice only for services rendered – such as drawing up a financial plan – not for administering your assets. She puts the figure at "probably two percent".

In the broadest terms, an independent planner may use some or all of these income-generators in various combinations:

- A fee per service (such as for drawing up a financial plan);
- An initial investment charge;
- An ongoing annual investment charge;
- A retainer (or a top-up fee);
- An hourly fee (particularly if the firm also offers the services of a lawyer and/or tax specialist); and
- Commission on insurance and investment products.

To put this in an example: all your savings of R1 million are in a money market account and you decide you want a proper financial plan that uses a wider range of appropriate investments. You approach the independent firm of Midas & Co to draw up a plan, the cost of which will be R15 000. Once you see the plan, you are comfortable with it and agree to implement it.

Midas could be entitled to an unacceptably high maximum of 3.5 percent of your R1 million as an initial investment charge.

Campbell says few independent planners use an initial charge. He says it can be hard to justify such a fee, because on large amounts it becomes substantial.

But you are likely to incur the annual investment charge, which you pay to the planner to administer your investment and to give you ongoing advice on any financial matter. It is also called the "assets under management" charge (and it is the one percent referred to in this article's introduction).

The maximum amount is one percent, but do not think that you *have* to pay this percentage; the rate is negotiable.

"The percentage depends on how much the client brings to invest," Campbell says.

You pay the fee every year on the value of your

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Adviser or planner?

IS THERE A DIFFERENCE BETWEEN A FINANCIAL adviser and a financial planner? The Financial Advisory and Intermediary Services (FAIS) Act does not distinguish between the two.

The Act defines a financial services provider (FSP) and an FSP representative. See the story "What you must be told" on **page 47** for the difference between the two.

The words "planner" and "adviser" are often used interchangeably, because the roles they play are not clearly understood. When using the words "financial adviser" the emphasis is on the products he or she sells or advises on.

If we look globally at useful definitions for "financial planner", four important distinguishing points are discernable. A planner:

- Conducts an analysis, from which he/she
- Creates an integrated plan that (if put into practice) will
- Enable the client to meet his/her financial objectives, and
- The planning is done with competence and professionalism.

John Campbell, the Financial Planner of the Year 2008, says: "There is a widening gap between what a client wants and what an adviser does."

In his view, the role of a financial planner should be that of the chief financial officer of the family. "All financial decisions, no matter how big or small, should be run past your family's chief financial officer," he says.

Not only that, your planner should fulfil the role of an educator who helps you establish what money means to you and what conflicts you have with it. Many clients have personal financial issues that they need to be taught how to handle, Campbell says.

As a guide, your planner will help you through tough situations, market downturns and life transitions, such as divorce and retirement. "The planner should help a client live a successful, full life and often this is not about the money."

portfolio. It comes off your investment and affects your bottom line directly.

Some firms have a policy that they cannot afford to look after you unless they get a certain amount of income from you every year. If this is the case, and if the money earned from your ongoing annual charge falls short of the predetermined amount, you pay a top-up fee. You may be able to negotiate with your planner to spread out the payment of the amount over the year.

In this example, Midas's policy is that it needs a minimum of R16 000 a year from each client. Your annual charge brings in R10 000 (one percent of R1 million), so you have to top up with R6 000.

When your planner sells you life assurance, disability cover, income protection or dread disease cover, the company that provides the product (such as Momentum) pays commission to the intermediary (your planner). The size of the commission is based on the premium you pay and the term of the policy. All commission is paid upfront to your planner in the first two years that the policy is in place.

Your planner will also get commission from selling you investment products such as retirement annuities and other pension products, endowment policies and sinking fund policies. Half the commission is paid to the intermediary upfront and the rest is paid over the term of the product. If you cancel a recurring premium product in the first five years of its existence, the product provider can reclaim a portion of the upfront commission from your planner.

Some firms offset the commission earned against the fees you pay, but Govender has a different view. "My belief is that a person has to pay for a plan and for advice, and any commission the financial planner earns is incidental, because he or she has already put in the time preparing the plan," she says.

In Govender's view, a practice cannot call itself purely fee-based if it offsets the charge to draw up your financial plan.

"There are two parts to financial planning: advice and implementation," she says. "If you are a purely fee-based practice, you will get paid only for advice."

>> According to the FPSB, the trend in Asia is for financial planners to develop but not implement plans on behalf of clients. Govender says in these cases, only the first four steps of the classic six-step financial planning process are covered:

- Gathering information;
- Determining your needs;
- Analysing the results; and
- Making recommendations and presenting these to the client.

"A person who derives no benefit other than either a straight fee or a monthly salary from a company to develop plans would be the ultimate fee-based planner," Govender says.

The steps that are missing from this scenario are:

- Implementing the recommendations; and
- Reviewing your plan over time.

Both Kiggen and Campbell consider it far from desirable to take away a plan and have it implemented by someone other than the creator.

Kiggen describes the practice as "dangerous". This is because the implementation is only part of the process, and it is the simple part, to boot.

"The key to a successful financial plan is the ongoing management of the structures being put into place. Really good financial planners are able to navigate the structure through the challenges life generally throws at a client," he says.

Campbell says: "If I wrote a plan for a client, the person implementing it wouldn't understand how I meant it to be carried out. It's about interpretation. If I write recommendations, there may be five different ways of implementing them."

Practice structures

THE CHANGE FROM COMMISSION STRUCTURES to a purely fee-based or mixed model can be painful for a planning firm. "If I had started out as a pure financial adviser, I would have had a few lean years. Our accounting practice carries us," Govender says.

Kiggen says a small or one-person planning practice will take on the clients it can afford, and these may only be wealthy individuals. If you can't afford the rates, Kiggen suggests you look for a large, multi-disciplinary, multi-level practice that can cater for everyone's needs.

Such multi-level practices have come about as a result of mergers – for example, the merger in 2009 between Consolidated Financial Planning, which has offices nationally, and Money Talk, which is based in Port Elizabeth.

These mergers resulted in a spread of experience and specialities within a practice. And that means a variation in the costs. "High-level planners, normal planners, and articled planners who are in training all represent very different cost structures," Kiggen says.

Govender says rates differ depending on the level of qualification. When advising purely on a tax matter, a person with a master's degree in tax is entitled to charge between R2 000 and R3 000 an hour.

You could pay between R500 and R1 000 an hour for financial advice, and this would be justified based on your adviser's qualification. She says an upper-end CFP professional will typically have a legal or accounting qualification.

"The scope of the work is also important," she says. "The price is automatically more if you are looking at trusts, for example."

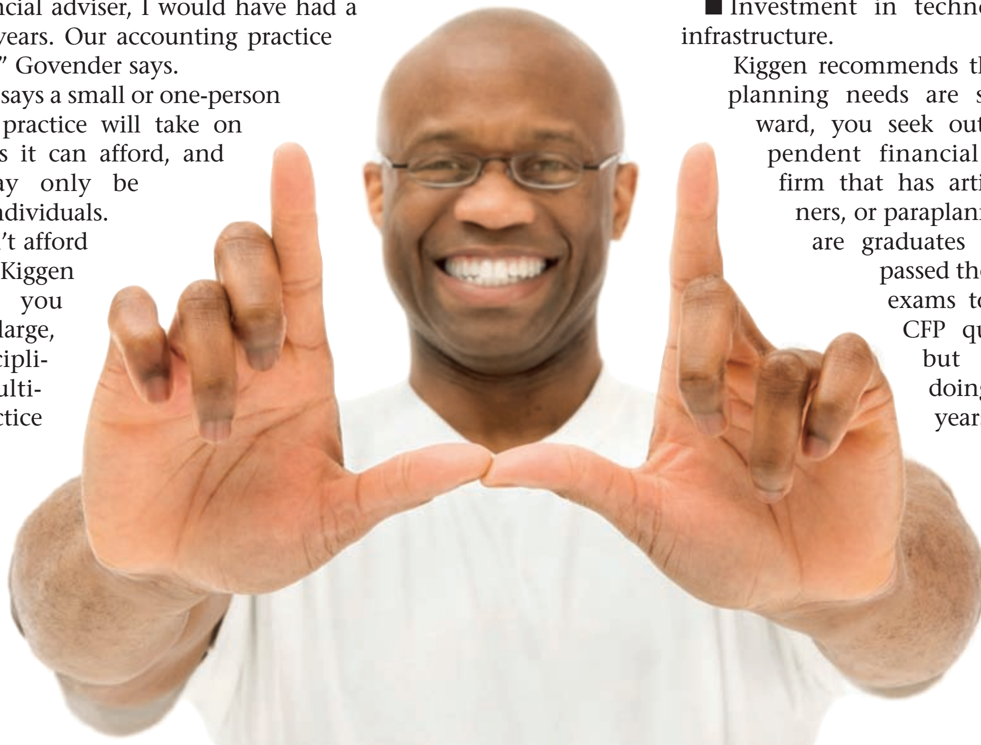
The FPI code of ethics has the following to say about what constitutes fair remuneration:

"The adviser may take into account the value of the professional service to the client, the customary charge for similar services by other professions ... and any other special circumstance which may exist. No single factor is necessarily the determining factor."

The code says that agreeing on a fee is a matter for negotiation between you and the adviser. The following factors should be taken into account when putting a value to the provision of a service:

- Skill and knowledge;
- Level of training and experience;
- Time taken;
- Level of responsibility; and
- Investment in technology and infrastructure.

Kiggen recommends that if your planning needs are straightforward, you seek out an independent financial planning firm that has articled planners, or paraplanners. These are graduates who have passed the necessary exams to get their CFP qualification but are still doing the three years' practical



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supervised training required before they can be accredited by the FPI.

The job of paraplanners is to help fully fledged CFP professionals. They are able to draw up plans in their own right, and at the same time they are supervised and everything they do is checked by a senior financial planner.

Firms charge considerably less for paraplanners' services than if you use a fully fledged CFP professional. (But be sure you understand and take into account the effect of other potential costs. For example, is there an annual fee on your portfolio? If so, is it lower than if you used the services of a senior financial planner? Is there a retainer? Will the retainer cancel out the savings for using a paraplanner?)

Kiggen says: "These graduates can look after smaller or less complicated clients, or those clients who require only maintenance on their portfolios."

If you have no dependants and you are an employee contributing to a company pension plan, then an articled planner may well be able to fill in the gaps in your financial set-up, such as sourcing good risk cover at the right level and helping you to work out how much you need to save to meet specific short-, medium- and long-term goals.

Govender concurs with Kiggen on the usefulness of articled planners to a segment of people with very straightforward finances. "If you don't need the full services of a fully fledged CFP professional, why pay for that?"

The analogy Govender uses is that if you have to keep a set of books for tax purposes but no audit is required, then would you pay a chartered accountant when a bookkeeper would be perfectly sufficient?

Campbell is not convinced. "You get what you pay for," he says.

He describes these junior planners as "somewhere between" an administrator and a CFP professional.

"They can give you good advice, but experience counts a lot in this industry," he says. "It is not an option to see only a junior planner."

Implementation costs

THE COST OF DRAWING UP A PLAN IS NOT THE whole story. Professor Jan Venter of the taxation department of Unisa, who did his PhD on financial planning, waves a red flag about the costs of implementing the plan.

Venter's research shows that these costs are at the root of the biggest expectation gap that clients experience. "Clients are much more concerned about the potential cost than the advisers think they are."

He says clients are concerned that they don't know exactly what the commission costs will be, "especially with products investing in other products investing in underlying products".

In addition, he says, clients reported uncertainty about the fee-based model, because they felt fees were not fixed at the start of the process.

HEALTH WARNING

WHEN IT COMES TO INVESTMENT COSTS, WORDS ARE used inconsistently among financial planners and commentators. This can increase confusion unnecessarily. For example, "commission" may be used in the traditional sense to refer to the commission paid by a life company to your adviser on the premiums you pay on your risk policies. But "commission" may also refer to the ongoing annual investment fee.

Another example is "retainer", which is used in this article to refer to the amount you may need to pay to your financial planning firm for it to retain you as a client if your annual investment fee does not meet a predetermined level. But some planners use it to refer to a particular service they offer (a service not covered in this article).

These are just two examples of a number of loosely used terms. Make sure you know exactly what your planner means, even if you are familiar with the generally accepted, dictionary definition of the words he or she is using.

The FAIS code of conduct requires that your financial planner gives you full information on how much you will have to pay, directly or indirectly, to your planner and to the supplier of any products you buy. (See "Talking costs" on **page 46** and the article "What you must be told" on **page 47**).

Venter says this does not happen in practice.

His study also looked at the opinions of registered financial advisers on disclosing information. More than one in five advisers surveyed did not unambiguously agree with the statement: "The financial adviser ensures all fees and commissions are clear, reasonable and fully disclosed in writing."

(In the research, the category of financial advisers included CFP professionals and others working in the broader industry, such as insurance brokers and accountants.) For more findings from Venter's research, see "What a client wants" on **page 49**.

Govender agrees with Venter that there are grey areas in financial planning costs that are not present in other professions. "If you go to a conveyancer, you know the property conveyancing costs upfront. And executor's fees are 3.5 percent plus VAT.

"How do you quantify costs in financial planning? And how long does it take to implement a plan?"

The FPI code of ethics says that the main criterion for remuneration is that "it is fair and equitable" for the client and the planner.

But is there a point at which the cost of the advice starts to outweigh the effect of the advice? What is a fair effect?

Venter says: "The problem is that normally it takes a couple of years to see the actual effect the advice has."

Paying for – and charging for – financial >>

>> services and products is quite unlike other goods and services, Lee Rossini wrote in *The South African Financial Planning Handbook 2005*.

Among the reasons for the difference, she says, are:

- The full cost of the product may not be known at the point of purchase;
- The product cannot be tested ahead of purchase;
- The client's future financial situation often depends on the performance of the contract, and surrendering a bad contract may incur substantial costs;
- There is often only a minimal guarantee or warranty attached; and
- Faults cannot easily be rectified.

Financial planners will say this makes it all the more important that you get advice from an impartial and well-trained professional. After all, you do not want to get to age 64 only to find that you have to carry on working because of a shortfall in your retirement savings. And do you want to wait until after an accident to find out whether you have the right amount of good-quality disability cover.

Planners are humans too

BUT ISN'T THERE A DANGER OF CLIENTS BEING over-serviced? After all, financial planners are humans too. Venter says that based on the discussions he had with advisers and clients, "the biggest problem clients have is they don't know exactly what they need".

To mis-quote American financier and presidential adviser Bernard Baruch, if you are holding a hammer, everything looks like a nail. And if you are holding a master's degree in tax, doesn't anyone look like a candidate for a trust?

Financial planning might not be a perfect science, Kiggen says, but maths is. "A financial planner needs to mathematically prove what he or she claims. So your adviser must run through the formulas if necessary. Shop around for a person and for advice you are comfortable with, and ask for proof."

One rule of thumb that Campbell offers is that you go to your planner when there is a change in your life circumstances. These triggers are when you need to see your planner (in addition to your annual financial health check).

"The average person goes through 64 transitions in his or her life. The big three are death, divorce and retirement. During these we make our worst financial decisions, such as opening a business when we retire. Other examples of transitions that should spark a consultation are the birth of a child and buying a house," Campbell says.

Venter says advisers sometimes say they provide a comprehensive service, "but, in fact, they focus only on their specialist area of expertise, for example retirement planning, and they under-emphasise other areas, such as proper risk management".

Govender's advice is: "Look at yourself: how technical are your needs? What level of advice are you in the market for? What is your net worth?"

Taking trusts as an example, Govender says: "It used to be that unless you had a net worth of at least R10 million, you didn't need a trust and wouldn't even be talking about them. Now this has risen to about R20 million."

Campbell says: "Every person has a unique set of circumstances. I have a client who formed a trust when he had less that R1 million in assets and today, nine years later, he is worth R30 million and is so grateful that I put his assets into a trust back then and not now. On the other hand, I have come across people who have as many as four trusts that they have never used. They have them because someone spun them a story, someone created a need."

Protection from "over-servicing", if such a thing exists, lies in the quality of your planner as a person and in the nature of your relationship.

"Your adviser should spend a lot of time getting to know you," Kiggen says.

Campbell says he or she be must be curious about you – about your history, your principles, your transitions and your goals. "Your planner must want to hear your story, and everyone has a life story to tell."

"There must be a genuine spirit of wanting to help," Govender says.

■ *To locate a financial planner, go to www.fpi.co.za or findanadvisor.co.za*

TALKING COSTS

THE FAIS ACT CODE OF ETHICS HAS VERY SPECIFIC requirements about cost disclosure.

It says that when your financial planner gives advice or sells you a product, he or she must tell you how much you will have to pay in rand terms. If it is not possible to determine the actual numbers beforehand, the basis of the calculation "must be adequately described".

The same requirement holds true for what you will need to pay the supplier of any financial products you buy.

You must also get full information at the earliest reasonable opportunity on how much in the way of incentives, commissions, fees and/or brokerages your planner may receive or become eligible for (directly or indirectly) from a product supplier as a result of rendering the financial service. Your financial planner should also disclose the nature of those considerations, how often he or she receives them, and who the product supplier is.

If you are offered a financial product that is marketed or positioned as an investment or as having an investment component, you must be given details of charges and fees, including how much you have to pay, and how often.

If the structure of the product entails other underlying financial products, you have to be informed in a way that will allow you to determine the ultimate net amount.