

IDEAS + INSIGHTS

'Perception Governs Behaviour' - #4 - Getting Paid

Multiple events in the financial services industry have driven the perception that payment by way of commission is becoming less acceptable than payment in the form of fees. A major issue has been the growth in importance of advice on financial issues. The media have certainly created the perception that commission payments taint the quality - and value - of advice. Rightly or wrongly, the days of commissions are numbered. We examine some key points.

In the middle of last century, following the second world war and the emergence of an identifiable middle class, life insurance companies pursued growth. Alert to the fact that it is far easier to quantify the productivity of management and clerical staff than that of sales people, they fixed on a policy of paying salaries to the former and commissions to the latter.

It was an almost perfect arrangement that stood for many decades. With little need for heavy regulation, small armies of sales agents went about their business, living as well as their personal productivity determined. Failures fell by the wayside, while the more successful survived, and the highly successful flourished, frequently earning far more than those who were paid to manage them.

Few complained: everybody knew their respective roles and policy holders - the public - were perhaps the greatest beneficiaries of all for, despite what today's journalists suggest, many a spouse and children escaped penury because an agent had sold (yes, *sold*) the family's breadwinner a policy of life insurance.

Fast-forward to the 1990s, and the property owning middle class had substantially grown. Their disposable income had risen as had their collective wealth. Life insurers either morphed into financial institutions or were taken over by banks as wealth management products expanded to meet new demand.

The financial planning industry superseded the life insurance model, and the law-makers created a regulatory framework intended to protect the investing public, who by now were also the beneficiaries of a regime of compulsory superannuation.

With increased complexity came the need for advice as well as investment products. Financial planners (the term 'agent' became antiquated) had to learn new skills and to pass examinations as proof

of competence to give advice.

Meantime, the one thing that remained largely unchanged was the method of compensation: financial institutions still identified commission as the most efficient method of paying intermediaries.

However, as the financial services industry grew in tandem with the public's wealth, a small minority of opportunistic spivs found a niche. Their egregious practice and mindless greed saw gullible victims lose a great deal of money. Lawyers encouraged class action and the fight to recover funds continues unabated.

This was grist to the mills of journalists who identified the payment of commissions as the underlying cause of the problem ... and created the perception

that payment of commissions is iniquitous (see article #3 in this series on Perception Governs Behaviour).

Whether commissions are evil or not is now beside the point: the negative perception has been created and it governs the behaviour and attitudes of most investors.

It is our view, however, that opportunity now knocks with the same intensity that negative press recently threatened.

Transition to a fee-for-advice model will resolve many current issues: it will satisfy the law-makers, mollify the journalists (on this topic, at least), appeal to clients, *and* remedy the inadequate compensation to planners that the commission system has masked. To these add the fact that accommodation will almost certainly be made for clients who would prefer fees to be paid directly from the products they ultimately choose.

If you would like to discuss an easy-to-use tool set to establish a highly profitable fee-for-service model, just call us when you are ready.

