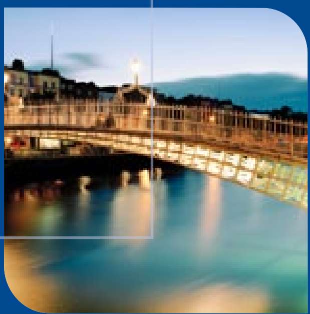
FINANCIAL PLANNING STANDARDS BOARD

GLOBAL PERSPECTIVES

Financial Planner Remuneration



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Financial Planner Remuneration

Many factors play a role in determining the quality of advice clients receive from a financial planner, including: the qualifications of the financial planner; duty of care to a client; conflicts of interest; disclosure; transparency; fully informed client consent; remuneration; a firm's business model; a client's level of sophistication; a client's investable assets; a client's intent; and the comprehensiveness of data gathering. Financial Planning Standards Board Ltd. (FPSB) has adopted a position on Financial Planner Remuneration that is both remuneration-neutral and business model-neutral to allow the financial planning profession to evolve and grow globally.

FPSB's position on financial planner remuneration is that:

1. **A financial planner's responsibility is to put the interests of the client first**; **and**
2. **The cost to the client of the services that are delivered should be mutually agreed between the client and the financial planner, and should be fully disclosed, transparent and compliant with local regulatory requirements.**

FPSB, through its member organizations and *Code of Ethics and Professional Responsibility* and *Financial Planner Duty of Care to Clients*, provides guidance to financial planners on ethical conduct, professionalism, duty of care to clients, management of conflicts of interest, full and appropriate disclosure of remuneration, incentives and biases, and fully informed client consent.

The Link Between Quality Advice and Remuneration Model

A 2006 comparative analysis of financial adviser remuneration models[1] suggested that inconsistencies in regulation and enforcement allow information asymmetries to exist between financial planners and investors, leaving investors vulnerable to manipulation and hindering them from selecting an appropriate remuneration model. In a comparison of three major methods by which advisers earn remuneration (commissions, financial assets under management (AUM) and fee-only), the study found that each model had advantages and disadvantages for the client, as follows:

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[1] John H. Robinson, "Who's the Fairest of them all? A Comparative Analysis of Financial Advisor Compensation Models," January 2006. http://www.hwm.wfadv.com/files/15310/Microsoft%20Word%20-%20Who's%20the%20Fairest%20-%20Compliance%20Version%20Jul09.pdf (This article appeared in the Journal of Financial Planning in 2007.)

Commissions (upfront and ongoing):

Advantages	Disadvantages
• Clients do not pay any out-of-pocket fees, which may help with client cash flow because the commission is deducted from the client's investment over time.	• A financial planner could be influenced to recommend a product with a higher commission, when one with a lower commission could be equally suitable.
• Similar products may offer different commission structures, enabling the financial planner and client to comparison shop for the most appropriate option.	• A financial planner could be influenced to recommend an investment into a financial product rather than paying down debt because doing so would ensure income for the financial planner.
• Commissions may offset or compensate for the true cost of financial planning services.	• The commission payment is typically an agreement between the product provider and the financial planner and not with the client (however the planner could agree on the commission with the client before placing the transaction).
• Because commissions are the predominant form of payment in many jurisdictions, consumers are already familiar with how they work.	• Without proper disclosure, the commission structure may be opaque to the client.
• There may be tax advantages for paying by commission – depending on product type and jurisdiction.	• Consumer apathy or lack of awareness could cause commission payments to continue to be paid with little or no service from the financial planner.
	• Commissions could be seen to link financial planning with product sales, which may lead to a view that planning is ancillary to product sales.

Financial Assets Under Management (or Percentage of Net Worth):

Advantages	Disadvantages
• The fee structure (usually a tiered percentage of assets held, or performance of assets under management) is transparent and easy for clients to understand.	• Clients may focus on the performance of the financial assets under management as a measure of quality of advice, rather than on the adviser's professionalism or the role of planning elsewhere in their financial life.
• The fee is an agreement between client and planner, not the product provider.	• The financial planner may not recommend solutions that do not involve asset management, because those solutions could reduce the planner's income potential. (For example: a financial planner could be influenced to recommend an investment into a financial product rather than paying down debt because, otherwise, the financial planner would lose income).
	• Potential influence for the financial planner to recommend financial leveraging or margin lending to increase the assets under management, thereby increasing the fees paid to the financial planner.
	• Cost may be higher than commission model for some clients (or may be lower).

Flat/Hourly Fee:

Advantages	Disadvantages
• Fee structure is transparent and easy for clients to understand.	• Flat-fee financial planners could be incentivized to provide "boilerplate" plans to minimize workload. (This could be true for other compensation models as well.)
• Financial planner has no incentive to recommend one product over another.	• Hourly financial planners could "pad" their time to increase income.
• The fee is an agreement between the client and the financial planner and not the product provider.	• Administrative costs associated with billing could increase client costs.
	• Clients may have to pay twice: once for financial planning advice, and a second time to purchase any recommended products from a product provider.
	• Costs may be higher than commission or AUM models for some clients. (Again, costs could also be less.)
	• The client may have to pay the fees using their after-tax income, which could create cash-flow problems.

The study suggested that requiring a client first (or fiduciary) standard across all three remuneration models would address some of the structural conflicts inherent in each remuneration model. Additionally, the study proposed that a client first standard, combined with professionalism, accountability and disclosure standards for financial advisers and enforcement by regulators, would be most effective at deterring unethical adviser behavior.

1. A financial planner's responsibility is to put the interests of the client first.

i. A financial planner should **place the interest of the client first**, at all times acting honestly, in utmost good faith, and in a manner he or she reasonably believes to be in the best interest of the client. The relationship between a financial planner and client is one of trust, requiring confidence on the part of the client that the financial planner is exercising his or her discretion or expertise for the benefit of the client. When holding out as a financial planner, regardless of whether he or she is engaging in financial planning services or in product sales, the financial planner owes the client a duty of care consistent with that of a fiduciary, regardless of employment arrangement, and should provide advice and product recommendations that are suitable for the client.

FPSB's Code of Ethics and Professional Responsibility Principle 1 – Client First states "Placing the client's interests first is a hallmark of professionalism, requiring the financial planning professional to act honestly and not place personal gain or advantage before the client's interests."

ii. The financial planner should manage his or her personal biases and **avoid, or manage and mitigate unavoidable conflicts**, so that they do not adversely affect his or her services or recommendations to clients. The financial planner should not place personal gain or advantage before the client's interests, and should evaluate the client's situation or other professional relationships without bias, recognizing that legitimate differences of opinion exist among professionals.

FPSB's Code of Ethics and Professional Responsibility Principle 3 – Objectivity states "objectivity requires financial planning professionals to ensure the integrity of their work, manage conflicts and exercise sound professional judgment."

2. The cost to the client of the services that are delivered should be mutually agreed between the client and the financial planner, and should be fully disclosed, transparent and compliant with local regulatory requirements.

i. The financial planner's non-salary compensation should be **disclosed** to the client in a manner that is clear, concise, understandable and comparable, and aligned to services that deliver value to the client. The cost for financial planning advice should be separately and clearly identified from other services provided by the financial planner and disclosed as an amount rather than a percentage, unless the total costs are unknown at the time of disclosure. Regardless of compensation model used, the financial planner should communicate to the client sufficient information about the likely consequences for the client of the use of a particular charging model.

FPSB's Code of Ethics and Professional Responsibility Principle 2 — Integrity, states, "Integrity requires honesty and candor in all professional matters. Financial planning professionals are placed in positions of trust by clients, and the ultimate source of that trust is the financial planning professional's personal integrity. Allowance can be made for legitimate differences of opinion, but integrity cannot co-exist with deceit or subordination of one's principles."

ii. The financial planner should **ensure that the client fully understands** the nature and scope of services provided by the financial planner, as well as the financial planner's areas of competence and practice. Additionally, the financial planner should ensure that the client is fully aware of what services and products he or she is paying for and the financial planner should secure the client's acceptance of the terms and conditions of the professional engagement.

FPSB's Code of Ethics and Professional Responsibility Principle 4 — Fairness, states, "Fairness requires providing clients what they are due, owed or should expect from a professional relationship, and includes honesty and disclosure of material conflicts of interest. It involves managing one's own feelings, prejudices and desires to achieve a proper balance of interests. Fairness is treating others in the same manner you would want to be treated."

iii. A financial planner should disclose all relevant facts to the client, initially and on an ongoing basis where changes take place, where the disclosure is necessary to avoid misleading the client or any other parties and to retain ongoing agreement between the parties in a financial planning engagement.

iv. A financial planner-client relationship should be **transparent** and based on open and regular communication that alerts the client to any potential conflict or bias, to any change in business practices or philosophy, or to any impending actions or consequences that the client can anticipate or mitigate their impacts.

v. A financial planner should meet professional **conduct and ethical standards,** developed and enforced by his or her professional or certification body. In addition to demonstrating ethical judgment and intellectual honesty and impartiality, the financial planner should recognize the public interest role of the profession and act accordingly.

FPSB's Code of Ethics and Professional Responsibility Principle 5 — Professionalism, states, "Professionalism requires complying with appropriate rules, regulations and professional requirements."

Oversight of the Financial Planning Profession

As the global professional standards-setting body for financial planning, FPSB works cooperatively through organizations in 25 territories to serve as a resource to regulators to help achieve the best potential outcomes for financial planning clients and other members of the investing public. While governments and regulators are required to set regulatory expectations for financial services and the protection of investors, professional financial planning bodies, such as the network of organizations that make up FPSB, can support regulators by establishing and enforcing professional norms, conduct expectations and education and certification requirements that foster financial planner professionalism and consumer and government confidence in the financial planning profession. FPSB, and its member organizations, work toward an oversight model for the financial planning profession that facilitates cooperation, fairness, transparency and that protects the interests of the public.

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