Commissions in the Crosshairs?

Keith Hickerson

The American College of Financial Services

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Commissions in the Crosshairs?
by Keith Hickerson, MSM

Are storm clouds gathering above commission-based financial advisors?

BE THANKFUL YOU’RE NOT

providing financial advice in the United Kingdom. Now that we’re into 2013, the Financial Services Authority’s (FSA) ban on commissions as payment for providing financial advice is in full effect. According to an estimate by a major consulting firm, 5.5 million people will stop using financial advice as a result.

Surveys repeatedly show that consumers are unwilling to pay large up-front fees for financial advice, especially families with smaller amounts of savings or investments. They’d rather use their money to purchase investments or products. Purists argue that consumers are paying for their advice through commissions anyway, but it’s a very different client experience. According to recent surveys, two-thirds of investing consumers in the UK say financial advice is worth no fee at all. The remaining consumers dramatically underestimate the fair value of financial counsel.

High-net-worth individuals, many of whom are under fee-based arrangements already, will not be dramatically affected. The middle-income investors who arguably need the most assistance, however, will be disproportionately harmed. Many will decide to take a do-it-yourself approach using random Internet advice and suggestions from friends and colleagues. It’s a perverse outcome from a well-intentioned, over-reaching regulatory structure and a recipe for disaster when it comes to retirement planning and financial security. The number of financial advisors serving middle-income customers has already seriously declined in the UK, and the ban just went into full effect.

Because new exams and financial advisor qualifications are also part of the new approach (further advisor education is the one part of the mix the FSA may have gotten right), the advisors who do continue to practice may ultimately be more qualified. The final result could be somewhat better financial advice for a small percentage of the population (those with the highest incomes) and none at all for the rest of the market.

The commission ban extends to life insurance products with any investment or savings component as well. There is a general sense among regulators there that commissions, in whatever form they take, should be replaced by fee-based compensation.

Keith Hickerson, MSM is a senior strategy consultant at The American College, Keith previously served as an executive at UNUM.
Keith.Hickerson@wcinput.com
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**WHAT DO WE HAVE TO WORRY ABOUT HERE?**

Yes, that’s across the pond, but the anti-commission trend is spreading. It has also hit the Netherlands, Australia and other countries. In the United States we’ve already seen commission pressure in the healthcare arena, and all eyes are now on the Department of Labor (DOL) as they regroup and re-propose their rules on new fiduciary standards under the Employee Retirement Income Security Act (ERISA). The DOL’s move could well impact IRAs, subjecting any advisor who works with IRA clients to a strict fiduciary standard. It’s certainly possible that commissions could be impacted. The details won’t be clear until the DOL’s new proposal is made public, but the final outcome could be a real blow to middle-income investors looking for affordable advice on their IRA investments.

Where the SEC’s fiduciary standard is concerned, Dodd-Frank’s language made it clear that receipt of commissions and/or access to only a limited product set would not, in and of themselves, place an advisor in any violation of a new fiduciary mandate. The wording is ambiguous at best, however, and does permit the SEC to ban any type of compensation they feel is detrimental to investors.

We can feel secure in established distribution models if we like, but we would be wise to be both a little worried and very aware of the trends impacting regulators’ thinking in this area. The assumption is too often made that an advisor working under a fee-based arrangement is somehow more ethical, more consumer-friendly and more objective than one who is paid through commissions. It doesn’t matter much that the perception isn’t true and that payment methods by themselves do not lead to increased conflicts of interest or creation of investor harm. The anti-commission bias has become the latest rallying cry of those who are not particularly knowledgeable about insurance in the first place, and it fails to consider consumer preferences and product access.

**SO WHAT DO CONSUMERS THINK?**

For all of the wrangling about how advisors are paid and the standards of care under which they should operate, consumers are not particularly attuned to either. Their concept of providing advice completely and purely in their best interest may also be different from the way we think about it. For a consumer, the pertinent questions may be more outcome based than process based: “Did I gain a better rate of return?” or “Did you lose any of my money?”

As part of the overall debate, it’s important that consumers, legislators and regulators understand how vital insurance products and services are to the economic health and security of our country. How often do you hear politicians talking about how important Social Security is to our citizens? The latest numbers I have show that Social Security pays out $1.9 billion daily in benefits—and insurers pay out $1.5 billion daily. But where’s the high rhetoric singing the praises of insurance and how it protects a full 20 percent of the long-term savings of Americans through a distribution system that’s unparalleled in terms of reach and access to products and services?

Isn’t it time we change the conversation?