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Fees and Commissions

The Ipswich Fee Based Adviser Group (IFBAG) is an alliance of Independent Financial Advisers whose clients pay fees for the advice they receive rather than commission when they invest. We firmly believe that charging fees rather than relying on commission from selling investments provides clients with an unbiased, non-distorted and independent service.

To help prospective clients understand the reason behind these views, these notes provide an explanation of the ways in which authorised financial advisers can be remunerated for the work that they undertake.

1. COMMISSIONS

When an adviser recommends a particular financial product, he is frequently offered a commission by the provider of that product. The commission is paid by the product provider either out of the initial investment that the client makes, or sometimes based on an assumption that investments will continue to be made in the future. The client pays for this commission through not having all of his investment going to provide the benefits he thought he was buying.

Levels of commission can vary from provider to provider and from adviser to adviser. It is possible for an adviser to strike a deal with a provider to earn a higher level of commission, and this is usually achieved through undertaking to direct a certain amount of business towards the provider.

Some but not all providers will offer to “reinvest” commission for the benefit of the investor. In this way, the investor has more of his money invested and the adviser is not paid the commission.

Some financial products do not pay any commission to any advisers. Notably, these would include bank or building society cash accounts or those offered by National Savings. Some Life Assurance companies do not pay commission.

Just because an organisation or product does not provide commission, does not mean that it is as good, or better than others that do. Remember The Equitable.

Having outlined the principle – that commission is simply a charge against the investor’s investment – there are then different types of commission to be aware of.

1.1 Indemnity Commission

Indemnity Commission is the system by which the product provider pays a large sum to the adviser at the commencement of a regular investment. The adviser indemnifies the provider to the extent of any “un-earned” commission. The value of the commission is dependent on the size of the regular investment and the term over which it is paid.

The “indemnity period” can be anything up to 4 years from the start of the investment. This means that if the regular investments are not maintained throughout that period, some or all of the commission can be “clawed back” by the provider from the adviser.

1.2 Initial Commission

This is commission which is paid on a level – rather than indemnity (up-front) – basis. It is paid for a period of up to four years depending on the type of plan and its term.

1.3 Level Commission

This is a level of commission paid on the same amount basis throughout the term of the plan.

1.4 Renewal Commission

This is commission paid after the initial period until the maturity of the plan. On regular premium investments this is usually 2.5% of the premium payable.

1.5 Single Premium Commission

This is commission paid as a percentage of the investment. It is only paid on single premium business. It varies from about 1% to perhaps 6% or more.

1.6 Fund Based Commission

This is commission paid as a percentage of the value of the investment usually on an annual basis. The rate is usually less than 1% of the value of the investment.

1.7 Soft Commission

These are usually non-cash payments. Things like offices and computers can be supplied to the adviser by an insurer or bank. These have to be paid for and if their free supply reduces the adviser's costs they are effectively a form of income, or cost to the manager, and hence effectively an expense against the investment.

2. FEES

An adviser that charges fees should be able to avoid the distortion that commission creates. Rather than relying on the sale of a financial product in order to generate his income, he will make a charge direct to the client for the work he has undertaken. There are a number of ways in which these fees can be accounted for:

2.1 Time Based Charges

This is where an adviser records the actual time spent working on a client's affairs. Time is recorded either on an accurate minute-by-minute basis, or by estimating time spent usually in units of 10 or 30 minutes.

2.2 Fixed Charges

Some advisers, especially those that concentrate on specific aspects of financial advice, may charge a fixed cost for a job. An example might be where a client specifically wanted to explore the pros and cons of undertaking a pension transfer from a former employer's scheme into a new personal pension.

2.3 Retainers

Usually expressed as a monthly charge, to cover the basic costs of administering a client's affairs.

2.4 Asset Based Percentage

Usually expressed as a percentage of a client's assets, either in total, or just those under the management of the adviser.

In practice, advisers may make charges based on a combination of these methods, or use any one in isolation. Through the course of providing fee-based financial advice, a financial product will often (but not always) be recommended. In the event that this financial product provides commission, it is important to establish what will happen to that commission.

2.5 Fee Only

Some advisers will never take commission even when it is offered, insisting that this is reinvested on behalf of the client. This can be acceptable when an investment offers reinvestment on a one-for-one basis, but may be to the client's disadvantage where the commission given up is not truly reflected in an enhancement to the financial product.

2.6 Fee and Commission

Some advisers will consider the process of advice quite separate to the process of investment. They will therefore justify charging a fee and then accepting any commission available as incidental to the advice process.

2.7 Fee with Commission Offset

This method will use commission received to offset any fee charged. By way of example, if the fee due is £3,000 and the commission available is £1,000, the client will be invoiced £2,000.

2.8 Fees with Commission Repayment

It can sometimes be appropriate for some or all of the commission available to be rebated or paid to the client. A fee is then either charged separately or part of the commission is used to offset the fee. Care must be taken where commission rebated can either give rise to a tax charge on the client, or in the case of pensions, compromise the tax relief on the investment.

3. WHAT IS BEST?

Members of The Ipswich Fee Based Adviser Group (IFBAG) are committed to the view that only through fee-based advice can an adviser truly act in the best interest of the client.

It is undeniable that a commission based adviser must use clients who generate commission income to subsidise those that do not.

It is also our view that by establishing a long term working relationship with a client, the exact method of charging fees and using commission is a matter for agreement between the adviser and the client.

These notes are produced on behalf of the members of IFBAG. We urge prospective clients to talk to the individual members to establish the actual method of fee-charging undertaken by the member firm.