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"Most IFAs claim to be client centred, but in reality most of them are investment-centred, and their client is the client's money, not the client".
Jim Stackpool, CEG Worldwide – Strategic Consulting & Training

Introduction

Running up to RDR one of the biggest concerns of the market was moving to a fee based environment yet most advisers seem to say they have found the move to be much more positive than they thought it would be. That is because most advisers do not really operate a true fee-based model but a more transparent commission model, without the smoke and mirrors of product charges. The focus is still on whether the client has money to invest, rather than on the client.

The market still has some way to go if it is to demonstrate true impartiality and be properly rewarded for the value that it adds. In fact being wedded to old FUM (Funds Under Management) based approaches continues to constrain a firms real earning potential.

This chapter will:

- highlight the need for the market to become more sophisticated in its charging approach and break away from a purely FUM or hourly rate approach, both of which have "significant" flaws.
- advocate understanding and using a Value Add & Fixed Pricing Strategy that I have developed with a number of firms which represents fair value for money and is consistently profitable to the firm.
- will examine the basic criteria for a successful pricing strategy, describe the pros and cons of common approaches to pricing in the UK advisory market and propose my own view of the most effective and sustainable approach to adviser charging.
- provide a very pragmatic example of how the recommended approach can be put together
- highlight why it may be fair to charge more for a platform enabled service, all be it a firm can deliver its services in less time
- touch on how fees should be collected

This chapter will focus on the fundamental basis of pricing. A later chapter will look at the mechanics used to determine price once processes for delivery are understood.

Back to Basics

The advent of compulsory adviser charging will lead to growing consumer awareness of how financial advice services work. Consumers will also learn how to gauge the importance and value of service delivered by various suppliers e.g. advisers, fund managers, platform accounts etc.

Chapter 9 – Choosing Your Firm's Pricing Strategy

Customers (or lack thereof) are the ultimate determinant of whether advisers' prices are "right". They make judgements based on whether they feel they are getting value for money and are receiving a service they regard as essential to their financial well-being and peace of mind.

Therefore, it is increasingly important that clients can clearly see a link between what they pay their adviser and the value they sought from engaging that adviser in the first place.

However, the way many advisers charge for their services and position the value they offer, often doesn't do justice to what they actually deliver. This can lead to questions in a client's mind about the demarcation between the role of their financial adviser and the fund manager(s) handling the decision-making regarding their portfolio.

Future Development

I believe that to truly move forward the market needs to break from its product and cost mind-set and focus on delivering what the client needs and wants, promoting the value of the proposition in meeting those needs and wants and setting a fair price for the broader value added.

Pricing Strategy

Of the 4 P's in the classic Marketing Mix (*Product, Place, Promotion & Price*), pricing is the most complex and at times the least thought through element of the mix. In a commission based environment the pricing has to a large degree been determined by the Product Providers, with the firms having flexibility to discount rates or trade initial commissions for trail fees. In a true fee environment nothing is prescribed, but most just choose to follow the herd or stick with old fashioned approaches.

Design a Price That Meets Your Aims and Those of Your Customers

Pricing is an iterative process. Fundamental criteria for your pricing strategy would include your goals and the strategic ambition of the positioning you wish to achieve through your business model i.e. Cost Leadership, Differentiated Offering or Niche Player.

- How much turnover and profit is required to meet your objectives?
- What does the business want to be known for?
- Who does the business want to attract and what does it want to provide to them?
- How many units (clients / customers) can the business deal with on this basis, at what cost and what price is required to meet the profit objectives?
- Is this price is too high from a market rate perspective?
- If so, consider how you can do things more efficiently to reduce the cost of provision and / or deal with a few more clients / customers at a lower margin.

Pricing Strategy Designed to Reflect Cost Leadership or Scarcity of Supply

Price speaks volumes about what a business stands for – are you a high volume, mass market, no frills, low price operation at one extreme or a lower volume, niche market, tailored, higher price service at the other end of the spectrum?

In a price-sensitive market, attention is paid to every little detail in order to drive out inefficiency and minimise cost. At the other end of the spectrum, charges will reflect the scarcity of the expertise required to solve more complex, higher value issues and deliver nimbler and more comprehensive services.

Chapter 9 – Choosing Your Firm's Pricing Strategy

One famous catch phrase springs to mind here "Reassuringly Expensive", Coutts.

Pricing Approaches

This next section will focus on the pros and cons of the main methods of charging for advice and service, namely commission, hourly rate fees, funds under management fees, value and fixed pricing.

Commission

"Customers won't pay a fee to be sold a product"
Alan Dick CFP, Forty Two Wealth Management

Whilst many advisers fought hard to sustain a commission pricing model and to a degree have done just that by maintaining a 3 plus a ½ or 1% model under the guise of a fee, it should be recognised that actually commission is the very thing that has held advisory firms back from being more profitable.

Let's just look at the problems with a commission model.

Prospect A comes to an adviser with £100,000 cash that he has inherited and wants to invest. He has no debts is retired and the advice is quite straight forward with monies mainly invested in ISA's and OEIC's for him and his wife. He earns £3,000 for no more than £1,000 work - fairly standard financial planning work.

Prospect B comes to this adviser and also has £100,000 to invest half in cash and half in three old pension policies. Best advice is to clear a £30,000 loan at 7% interest, and then he goes through the work of transferring the pensions to a more cost effective option with greater fund choice and take out a couple of ISA's too. In this situation he earns £2,100 for a lot more cost and has added quite a lot more value to the client's situation.

Finally ***Prospect C*** ends up investing £100,000 into a Bond under a Will Trust. The advice was focussed around IHT planning and the adviser got these older clients to take out Lasting Powers of Attorney, equalise their Estate and transfer appropriate assets into a Will Trust arrangement realising £15,000 capital gains allowance for them at the same time. In addition they saved £100,000 IHT for their beneficiaries as a result. Now the adviser earns £3,000 for quite a bit of work and for how much more value?

Let's be clear that the commission model for Pensions & Investments has always been flawed and advisers should welcome its demise. Maybe the correct fee, considering costs and value, for Prospect A would have been something like £1,500, Prospect B £3,000 and Prospect C £7,000.

How shocking 7% commission! No not if the advice delivered that sort of value, what was probably more shocking was the charge to Prospect A. Herein lies the problem with the commission model, the value of the advice is not limited to the advice on the product, but the context of the advice in which the product plays a part role. Remember from the last chapter the product is only the servant of the plan. I would guess that the commission model would only ever strike a fair price for the cost and value delivered in 10% of occasions.

The market capped commissions and the regulator / compliance would frown on advisers using in excess of 3%, yet the true fee based adviser would have comfortably charged £7,000 (7%) or more for what he had done for Prospect C.

The other problem firms should be mindful of is that if the client sees the product / investment as funding the advice they will naturally view it as that is what they are paying for and only measure the value retrospectively against the performance of the product / investment. Thus the client is in danger of failing to see the broader value of the advice they got and the firms reputational value is overly weighted on something they have no control over – the product performance. If the product then performs poorly the client is particularly critical of the advice received.

Firms therefore should seriously consider whether they want to sustain this type of approach under the guise of a 3 plus a ½% pseudo fee model? It is commission as ever was but just without the opportunity now to use enhanced allocation models to hide the fact the client is paying.

Hourly Rates

A woman was strolling along a street in Paris when she spotted Picasso sketching at a sidewalk cafe. The woman asked Picasso if he might sketch her, and charge accordingly.

Picasso obliged. In just minutes, there she was: an original Picasso.

"And what do I owe you?" she asked
"Five thousand francs," he answered
"But it only took you three minutes," she politely reminded him.
"No," Picasso said. "It took me all my life."

Whilst hourly rate charging is the method historically adopted by other professionals and is always an option it does have its limitations, particularly in the area of enabling a firm to realise the true value it adds to clients with more complex and sophisticated needs.

The Picasso story illustrates the value is in the experience built up over a number of years, the skill and the talent and not in the time taken to complete the task. This lady could have done a self-portrait. It would have taken her longer to do and wouldn't have been a patch on what Picasso could do. Clients can do their own financial planning if they were minded to, but it would take them longer to do and they would probably have a different solution and seek reassurance that what they had come up with is what an experienced adviser would have suggested. Again time saving and peace of mind are key drivers as to why clients seek service and advice.

There are advantages to hourly charging as well as disadvantages, so let's look at these

The Advantages of Hourly Billing

- It is a relatively easy and efficient pricing method particularly with the advent of computers to ensure each job undertaken is profitable
- Sometimes the customer demands it
- Documents and evidences the effort undertaken
- Cost accounting tool, its single biggest advantage – to measure efficiency and profitability
- Transfers risk to the customer should unforeseen circumstances arise and the job takes longer than anticipated and goes over budget.
- It creates a comfortable floor beneath the firm, because a decent net income is inserted in the cost-plus accounting formula. But in exchange for the comfort of this floor, firms have created an artificial ceiling, which they cannot seem to rise above.

The Disadvantages of Hourly Billing

- When you make hours important then the customer is bound to focus on hours. Those professionals caught "padding" timesheets because they believe the value of what they did exceeded the price measured in hours will lose the respect of their customers.
- This conflict of interest also exists because in a cost-plus pricing system one way to increase a firm's revenue is to increase its costs (i.e. staff / Director / Adviser salaries).
- Hourly billing focuses on hours not value. The multidimensional value that professionals provide is turned into a one-dimensional commoditised billing rate. Firms need to educate the customer regarding the value they provide, including factors such as resources of their firm, the experience and judgement of their team members, the risk they are assuming and the convenience they are providing.
- It places the risk on the customer. If you offer a fixed price you will be able to charge a premium because you are reducing their risk. E.g. fixed rate mortgages are usually at a premium, fixed quotes for a house build are favoured to, an add it up as we go approach etc. People pay more for "Peace of Mind".
- It fosters a production mentality, not entrepreneurial spirit. Firms have rewarded production, measured in hours, and have been slow to recognise customer service, retention, loyalty and other yardsticks of long term profitability.
- It creates a subsidy system – if a business has to undertake a new piece of research for a client that takes many hours to conclude at a cost of £5,000 then another client which has the exact same issue at a later date may only incur a charge of £1000 as the research has already been carried out. If the firm charges the £3,000 for the first and subsequent clients this could be deemed as pay-back for its R & D expense and not charging the initial client for the adviser / firm's inexperience.
- It encourages hoarding of hours. As reward and recognition is usually linked to billable hours, this does not encourage low level work to be delegated to others. Just as surgeons should not pierce ears, managers and advisers should not spend their time on administrative work.
- It does not reward creativity and ingenuity. On the contrary it rewards inexperience, inefficiency and even incompetence. This is precisely why professionals pad their timesheets. Not only is it the perfect crime, it is the logical and rational course to take if you believe that what you did is worth more than the time you spent. By focussing on the hourly rate, you are forced into a Hobson's choice. Either be honest and undervalue your services, or lie on your timesheet to collect your just compensation. Also Parkinson's Law applies "Work expands to fill the time available for its completion".
- There is less incentive to implement more efficient technological systems as this would serve to reduce revenue by cutting billable hours, putting extra pressure on the business to find new clients and business.
- Hourly rates are set by reverse competition. Often people simply benchmark their pricing with local competition and pitch somewhere in the middle. Me-too pricing leads to serious pricing errors, as they do not consider their own real cost structures. Pricing policies need to be more sophisticated than this, based upon an assessment of value to the customer rather than on conjured-up standard rates by competitors.
- It creates bureaucracy, which paralyses the productivity of an organisation and also reduces morale.
- Few products or services in the market place are purchased without the client knowing the price up front. By not setting the price up front, the customer has no control over the situation, which is not a good position to put your client in. People like to feel they are in control, especially when they are spending money.

In fact if a client asks an adviser what their fees are and they say £150 per hour, the next inevitable question is going to be, how long will it take? The focus is immediately on cost and not value. You may have one adviser who charges £150 per hour and another £120 per hour but if the first takes 5

hours to do the job and the second makes the job last 8 hours then the client is worse off going with the second adviser "assuming" they provide the same end advice.

Whether price is discussed up front or not, rest assured that the customer has some price in their mind. This may be based on what they have paid in the past, a quote from a competitor, or a completely unreasonable estimate that they have pulled from thin air. The time to find out what they think is before your firm has performed any services, rather than after, when you will be on your knees trying to collect a bill from the customer whose value assessment is radically different from yours.

Price alone does not differentiate your firm. Low pricing is not an effective competitive differentiation, unless you enjoy price wars, since someone somewhere is always willing to do what you do for less money.

"There is hardly anything in this world which some man cannot make a little worse and sell a little cheaper and the people who consider price alone are this man's lawful prey, as it is unwise to pay too much as it is to pay too little.

When you pay too much you lose a little money that is all.

When you pay too little you sometimes lose everything, because the thing you bought was incapable of doing the job it was supposed to ***do."***

John Ruskin (1819-1900)

Price is one of the most important signals that a firm can transmit to the marketplace regarding its services. Up front pricing projects confidence and experience on your part, characteristics valued highly by customers even if subjectively.

Hourly rate billing diminishes the quality of life. It creates a sweatshop environment. The worker lives to work rather than works to live. The pressure to fill billable hours overtakes the extra value gained from investing some of that time in self-development to do a better job.

As you can probably tell I am no fan of hourly rate charging from either a client or a firm's perspective. It is important for a firm to understand its hourly costs for certain tasks but it shouldn't be the sole means by which a fee is calculated.

There seems to be a preference in the Market Place for fixed price agreements rather than bills based on time spent on the case. Even the older Professions of Solicitors & Accountants are moving more towards fixed pricing.

To summarise: Reasons not to charge by the hour

- If you charge time, all the risk is the clients – if the work takes a long-time he picks up the tab. You should have the experience to price the work correctly
- It is not fair on either party for work to be taken on without knowing what the price would be
- Billing for time focuses on effort and not necessarily on results
- Reward based on time encourages inefficiency and ultimately the firm will not be competitive.

- When choosing a Financial Adviser, many clients focus on hourly rates rather than the benefits and standards of service. By not quoting hourly rates you encourage the focus to be on the value of the service.

Funds Under Management

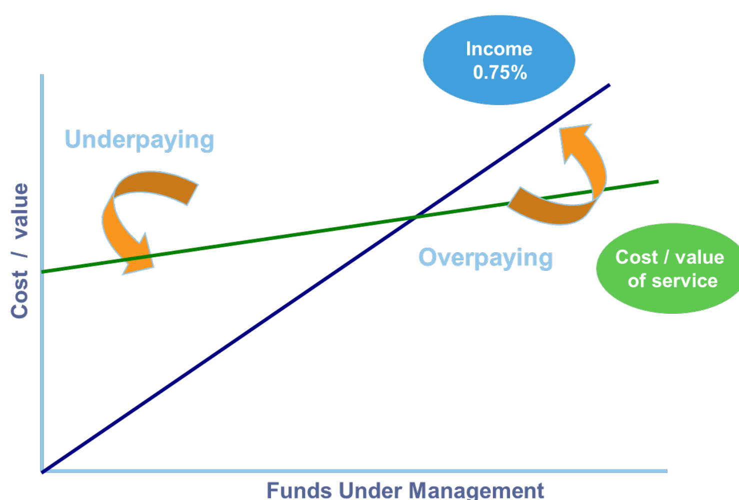
This is the most common mechanism used in the market for charging and collecting fees. As per the argument I raised with commissions it is a flawed model for charging on an initial fee basis for advice. It rarely fairly rewards the firm to cover the costs it incurs at the lower end and or the value it delivers at either end of the spectrum.

Firms can apply a minimum fee and or only agree to work with clients that have a minimum level of investable assets. Applying a minimum level of investable assets can actually exclude a significant market opportunity with income rich prospects who seek help and advice in accumulating wealth. It also presents challenges to a firm in future to have difficult conversations with clients when their funds fall below their minimum threshold and are no longer profitable to service, be it through a disinvestment strategy or worse still poor investment performance.

Its main advantages as a fee charging mechanism are:

- It is familiar to previous charging basis
- It is easy to reflect risk premium
- It is easy to explain and to collect
- It is probably the most common and therefore familiar method currently
- It can be adapted to cater for smaller or larger investments
- Motives are aligned - reward linked to investment all be it what control do many advisers actually have of the markets and fund performance?

For me the bigger issue with this approach is the longer term implications of using this approach for service based agreements. Let's look at a typical adviser model where they apply a standard on-going FUM, say 0.75%



Clients with lower portfolios will be underpaying relative to the cost and value of what they receive and the firm either: loses money on them, reduces the services they offer, ignores them or manages them out. At the top end of the spectrum a firm may get challenged by a client to provide a discount on the basis that it doesn't take 10 times as long to look after their £1 million as it does someone else's £100,000, which is correct. So a firm is faced with increasing pressure to manage out cost at the lower end of its client base and or charge a minimum fee and consider discounting charges at the top as it can no longer cross subsidise clients.

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Let us look more closely at an illustration of how these flaws can be more clearly seen by comparing two clients side by side both who have £250,000 in investable assets that their adviser monitors and manages. This is where their similarity ends however.

Client A	Client B
Earning £150k pa	Earning £50k pa
Estate £1.5 million	Estate £1 million
Wants 2 visits and reports pa to their house	Wants 1 visits and reports pa in your office
Adventurous investor	Cautious investor
6 products / platforms	3 products / platforms
Discusses all aspects of financial affairs	Only discusses investments

Client A has an income 3 times that of client B's and has an Estate in which his £250,000 sits that is 50% larger. Client A wants to be seen more often each year and have his adviser come to him, whereas Client B comes to the adviser's office. Client A is more speculative as an investor and looks at more adventurous funds and maybe products too. Client A also wants to discuss all of his financial affairs when they meet whereas Client B is simply focussed on how his £250,000 is doing.

Now client A is clearly costing this firm over twice as much to look after and he is probably deriving three, four fold or more value than Client B because of the depth, breadth and frequency of the discussions they are having. Yet in many advisory models they both pay the same, typically 0.5% (£1,250) or 0.75% (1,875) or 1% (£2,500).

Again the firm has fallen into the trap of associating value with the level of FUM and attaching its reputational risk and profitability to the performance of the FUM and placing themselves in a position where they may need to have some difficult conversations with clients when it comes to disinvestment or funds dropping below a minimum threshold.

Fixed & Value based pricing

So where do we go from here.

The main dangers with fixed pricing are that:

- the onus is on the firm to price the work correctly and operate to the required level of efficiency to ensure it is profitable
- if the project throws up additional work then it could cost the firm more to deliver if it does not caveat this in their fixed price agreements

The reasons for considering a fixed fee approach are:

- As time can't be charged, the firm is constantly looking to demonstrate its expertise through spotting ways to save tax, improve cost savings, enhance potential investment returns, deliver high levels of service, save time and provide peace of mind.
- Fixed price agreements encourage firms to search out efficiency savings in their work processes to deliver better services and improve margins. This will make them more competitive and enable them to attract new business, maintain service and grow.
- It isn't fair also to have earnings limited purely by time or FUM

- It may only take seconds to come up with a cost or tax saving idea, but it is a result of years of study and experience. This is the kind of expertise upon which a firm's true potential needs to rest and upon which clients should be charged.
- Fixed prices provide the client with surety up front and enable them to make a measured decision as to whether they perceive the price to be value for money. That therefore places the emphasis on the firm to illustrate the full value of the advice and service they provide for the fee that will be charged. This reduces the chances of complaint and disagreement down the road.

Value pricing

The successful professional service firms of today will price their services according to external value as perceived and determined by the customer, rather than by internal costs. By so doing, they restore pricing to the strategic marketing tool that it is.

Value pricing has a very positive connotation and should become part of the firm's culture and hence terminology. The term pricing with customers is far more friendly than billing. The word value has an even more specific meaning. It means "The maximum amount that a consumer would be willing to pay for an item" (Steven E Landsburg 1996, author of Price Theory & professor of Economics). Indeed if few clients seek to negotiate on the price it could be giving the firm a message that it is too cheap.

Value pricing requires that you price on the margin for each customer, for each service, disregarding the following:

- What you charge other customers for the "same service"
- What you have charged the customer in the past
- What your competition is willing to charge the customer
- What the competition used to charge the customer

It enables you to price at the margin and hence leverage greater return to fairly reward the value you add to a client. Every client is unique and indeed each adviser and so dare I say it could the price be!

Examples of pricing on the margin are all around us, and clients accept it. Some passengers elect to pay first class air fares at ten times the cost of the standard rate, although it costs less than three times to carry them. Hair stylists charge a lot more on a wedding day than usual and they also invariably get a generous tip to add to the already inflated price. Some people will pay exorbitant prices for tickets to certain shows or sporting events that others wouldn't dream of paying.

The Picasso example earlier highlighted the simple principle - Charge by the years not by the hours! This is of course where talent and experience is being used to add value. That said not everyone would pay some of the prices asked for a Picasso even if they had the money – the same thing can be valued by different people to different amounts for different reasons and every client is unique in terms of their circumstances, needs, wants, fears and goals etc. Indeed Client A may be more speculative and laissez faire than Client B who has a very nervous disposition and want more reassurance as to how their money is doing. The Peace of Mind an adviser brings to Client B is worth more than Client A.

Value pricing is an art form, not an exact science. Whilst this is perhaps the ideal method to maximise the benefits to the firm, it may for many be either a step too far or too fast to apply immediately. It also may present some challenges in meeting the regulatory requirements around fee charging – particularly in terms of providing a clear and consistent approach applied by all advisers within a firm.

How might this work to some practical level in our Industry and meet the regulatory requirements?

A scientific approach to calculating value and service fees

Whilst value is in the eye of the beholder and is somewhat of an art form, I have helped some firms apply a degree of science to how they calculate their fees to ensure that what they quote is profitable, fair and consistent as well as considers the value they add.

Going back to the Client A & B example earlier we might more fairly charge these clients as follows:

Client A

Earning £150k pa	£150 (0.1%)
Other assets £1.5 million	£750 (0.05%)
Wants 2 visits and reports pa to their house	£500 (£250 per meeting)
Travel charge 30 miles x 4	£120 (£1 per mile)
Adventurous investor	£125 (0.05% towards PI)
6 products / platforms	£240 (£20 per product and review)
Discusses all aspects of financial affairs	£560 (£35 x 4 areas x 4 visits)
Investment Management (0.3%)	£750

In advising a client an adviser will be considering the effect on someone's income and capital gains tax position and so a charge may be made in relation to the income of the client. Equally the value of an hour saved for a £150,000 a year earner is greater than a £50,000 a year earner. Also in doing full financial planning the advice will have an impact on the wider Estate and IHT planning, so maybe a charge on the wider assets advised upon may be considered (including or excluding the main residence). The frequency of meetings is an obvious expense to be charged, and if a client wants their adviser to come to them as they see a value in not spending their own time and expense going to the adviser then a charge for that may be considered. After all those clients who want advisers to come to them are reducing the time available for the adviser to look after other clients.

The more speculative an investor the greater the risk they bring to the business and therefore potential PI cost too. The more complex their affairs the more products / wrappers they may have to administer and areas of financial planning that have to be reviewed and reported on. Finally there is the FUM itself. In this area I have known firms apply different rates and bands depending on whether they have outsourced to a multi-manager, DFM or run their own model or bespoke portfolios, with higher charges to cover the cost and risk associated with running portfolios in house and reduced charges for outsourced options.

Now the fee for this client in this example, for this year would be £3,195. That equates to just under 1.3% of FUM. Someone in Compliance may argue the adviser cannot charge 1.3% of FUM, but I would argue why not? The adviser isn't charging 1.3% to manage the FUM, he is just charging 0.3% for that job. The other 1% is for all the other added value he is delivering. Indeed this fee is probably less than the annual CGT savings he may be helping the client realise. If the client only wanted was his money to be managed with no reviews then 0.3% is all he would be paying and no-one would bat an eye lid over this.

If Client B was being charged 1.3% then that would be unfair but in this model he might be charged as follows:

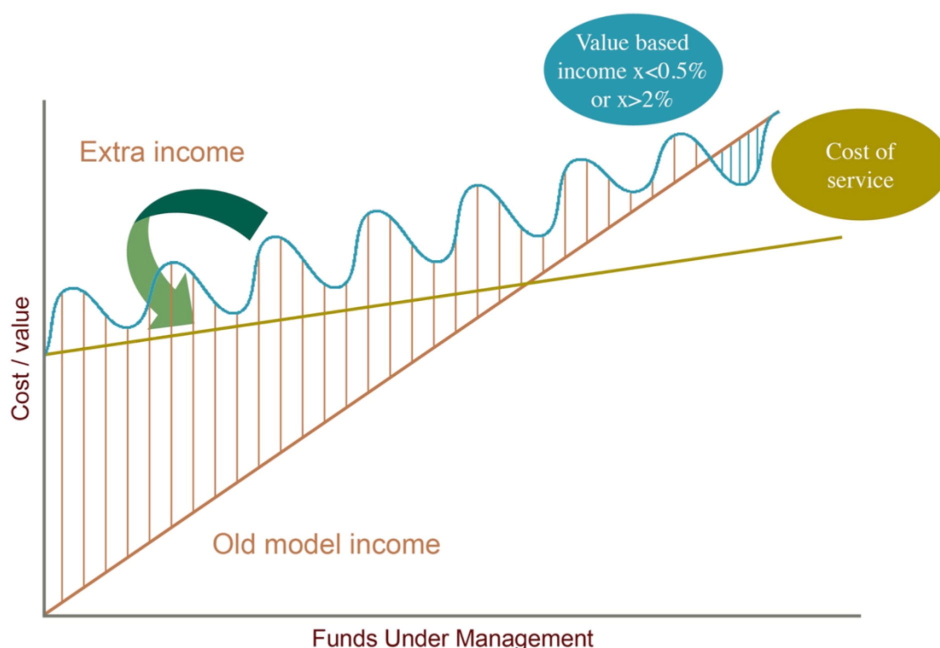
Client B:

Earning £50k pa	£50 (0.1%)
Other assets £1 million	£0
Wants 1 visit and report pa in office	£250 (£250 per meeting)
No travel charge	£0
Cautious investor	£0
3 products / platforms	£60 (£20 per product and review)
Investment only	£50 (£50 x 1 area x 1 visit)
Investment Management (0.3%)	£750

As he isn't looking at full financial planning and is more cautious and travels to the adviser's office and only wants to meet once a year, he only pays £1,160 per year, an effective rate of 0.46% of FUM.

What is more if the right advice is for Client A & B to move to cash for a period of time, whilst the money moves out of FUM it moves into the other assets category and the other charges would still apply. Client A would for that period be paying £2,205 (0.88%) without a charge for the FUM, products or PI risk. Client B would be paying £475 (0.2%) for a very straight forward review in house.

Such an approach enables a firm to demonstrate greater impartiality around the advice they provide and continue to offer a profitable service to clients as their circumstances change. It ensures clients with current lower levels of FUM can be profitable and recognises that clients with larger FUM have larger Estates into which the FUM is only a part. As a result they bring greater complexity and risk, have higher service expectations such that discounts are rarely required. It may not take 10 times as long to look after their million than another's £100,000 but the value they get can be significantly higher as they require greater application of a firm's expertise, skill and talent in the advice they get and they will expect resources to be available when they need it, to be proactive and reactive



I am not saying that the criteria used above are the right ones, or the rates and figures are correct. What this framework enables a firm to do is price every client on a fairer basis based with consideration of cost and value overcoming the flaws of purely an hourly rate or FUM only approach does.

Potential charging criteria for an annual servicing fee:

The following is a list of a number of factors that may be considered to establishing an annual service fee:

- Number of face to face meetings
- Number of telephone or interim reviews
- Out of office charge, rate per mile
- Out of normal office hours charge (evening or weekend rates)
- Rates for FUM managed dependent on:
    - Who is managing the portfolio –
        - Outsourced to Multi-Manager or DFM,
        - In-house Model or in-house Bespoke Portfolios (highest charge)
        - Partial outsource – bought in Models or Panel of funds
- Charges to maintain portfolios dependent on:
    - Old style products,
    - platform / supermarket o/s of the core proposition or
    - on preferred platform / supermarket for service delivery
- Attitude to risk
- Number of market areas to be reviewed – different ones may have different rates and a discount applied to full financial planning
- Cash-flow plans updated
- Tax returns to the Accountant
- Cash management / advice
- Other assets advised upon but not directly managed
- Liaison with other advisers – Trustees, Solicitors, Accountants etc.

Most firms I have worked with that have broken away from a limited FUM or Hourly rate approach and would typically use 4 or 5 of these criteria, but a small number have used nearly all of them. The most common being:

- FUM – with different minimums and bands dependent on type of Fund Management Service offered
- Number of meetings, with different rates for Full Financial Planning, Narrower Financial Management and interim reviews.
- Other assets advised upon
- Number of products / wrappers used
- Travel charge by the mile

As clients circumstances change each year, the fee should probably be reviewed annually as part of the annual review and agreed for the following year. Many, particularly those who use a platform with flexible charging options, still collect the fee from the FUM. If they do not have this facility with the products / platforms the client is invested in then any differential needs to be collected from the client's bank account.

Initial Fees

This section will consider alternative ways to charge for advice to brand new clients and new advice for existing clients.

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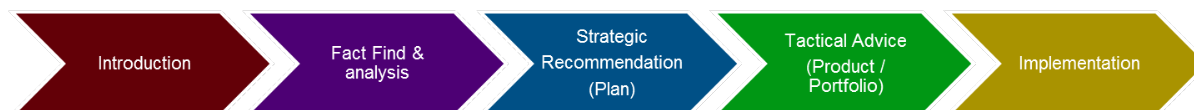
When it comes to charging for the initial advice process when engaging with a brand new prospect some firms still operate a no win no fee model on the basis that most clients are referred to them and they will do business with 80 to 90% of them. They may rely on some good pre-qualification work to limit the risk of those that won't proceed or the probability of the returns on those that do proceed generating too little revenue to cover their costs.

Whilst better target marketing, more selectivity in proceeding with clients and better articulation of the proposition can help to manage out unprofitable clients, to operate a no win no fee basis can run counter to promoting a message around being a fee based adviser and offering true impartiality. With this approach you are dependent on making a sale and hence clients could harbour a degree of suspicion as to the motive behind the advice.

Whilst this still remains the predominant stance in the market there is a growing trend and confidence in the market to charge fees on a purer basis at different stages of the advice process. In its purest sense I see five stages of the advice process four of which can have a charge applied in their own right.



Introduction

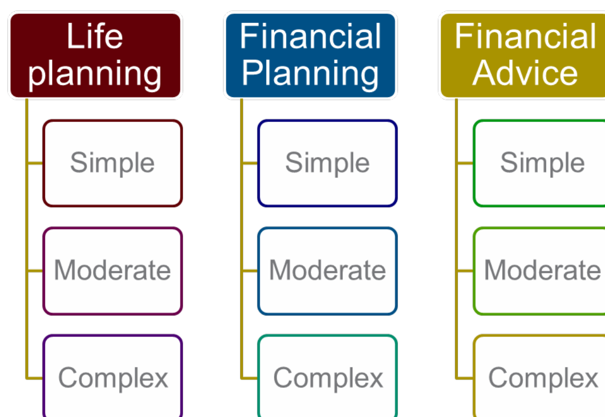
This is usually covered as an initial ¼ to ½ an hour section of the first meeting where the adviser gets an overview of what the client is looking for, explains how they work and establishes if they can work together and if so on what basis and for what fee(s). This initial time is often delivered free of charge or referred to as "at our expense".

In most instances this shouldn't throw up any real barriers if a firm has pre-qualified the prospect by way of the fact most clients are referred and the referrer may have explained what to expect. There will also have been some telephone contact prior to the meeting and maybe a proposition document sent out in advance.

Fact find & gap analysis

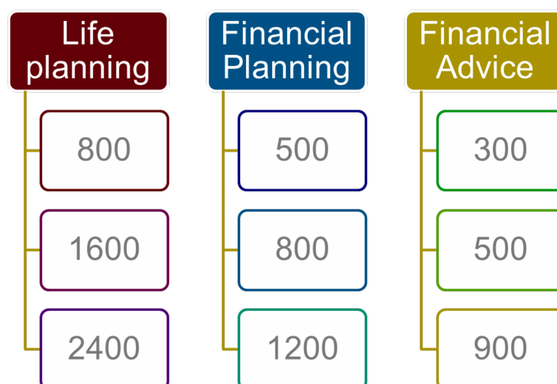
More and more firms, particularly those that are offering Life and Cash-flow planning as part of their proposition, are charging for the completion of the fact find and production of a gap analysis report. A report that illustrates what a client has, their objectives, whether there are any gaps and if so the size of them and potential implications of those gaps remaining.

Helping clients get an understanding of the current position, the issues that need addressing and prioritising them has a real value and where there is a value a fee may be applied. This work can vary significantly from one proposition and one client to another. At one level we have the depth and breadth of the proposition being offered. Life Planning may require three meetings to get to a Strategic Financial Planning phase, a Financial Planning Proposition may take a couple of meetings and maybe a Financial Advice Proposition only requiring one meeting before preparing a recommendation.



Then there is the complexity of the client situation. Is it a simple, straight forward scenario we are looking at with a young married couple, no children and limited assets, or a moderately complex situation of a couple in their 40's looking at all aspects of financial planning with children or a complex wealthy client with a range of historical assets approaching retirement and IHT issues to consider.

I would suggest that each proposition offered may have a standard or benchmark fee that is applied according to the complexity of the client that would be quoted and agreed at the end of the introductory phase of the meeting. The figures used below are not recommendations or market averages but simply an illustration of how the relative charges might look.



There is a challenge as to defining what constitutes simple, moderate and complex that all advisers across the business can be seen to apply consistently. I would hope that the Regulator would understand that every client is unique and as long as a firm is working within some framework and the client knows and agrees the fee for this work before they incur a charge a degree of flexibility is acceptable that they would be comfortable with. In an ideal world these figures aren't definitive but benchmarks and most clients would fall someone between these numbers rather than just quoted one of three prices. After all the reverse is true, some clients may pay different rates to others for a similar service if they themselves are better negotiators than their adviser.

Strategic recommendations & plan

This is not necessarily incorporating product or portfolio specific advice but offering the client an agreed financial planning strategy to solve their financial planning gaps in priority order. So it will explain the funding requirements, the tax wrappers used, the trusts to be considered etc. This is where considerable value may be added and yet best advice may be to do nothing at this stage, repay debt, or disinvest or simply utilise trusts etc.

Chapter 9 – Choosing Your Firm's Pricing Strategy

From this report a strategy is agreed and the first steps and solutions prioritised. This may or may not then move to some Tactical Advice (Product Solution). The cost and value of this advice may be calculated in the old fashioned way, a percentage of FUM or for protection based products a commission. Given in this model we have charged for the cost and value of what has been done in the fact find stage of the process, the use of charging more in line with the value of the money advised upon becomes more appropriate. We may however consider fees chargeable according to:

- A percentage of new pension investments
- A percentage of the existing pension pots to be transferred or to be drawn down
- A percentage of the investment funds to be advised upon (OEIC, ISA, Bond)
- A percentage of any esoteric products advised upon (VCT's, Film, EIS etc)
- A percentage of the Inheritance Tax to be mitigated against
- A percentage of the Capital Gains & Income Tax saved
- A percentage of the income / profits / shareholdings / capital to be protected for the family or business
- A percentage of savings on mortgages & loan costs
- A percentage of additional returns on savings on deposit
- A percentage of savings made on insurances, assurances and other household expenses

When setting these figures a business needs to remember that compared to the old world they have already made a charge for the fact find and gap analysis work and as yet have not provided product specific advice, so some of these rates / figures in some instances should look lower than in the old world.

For instance a firm might operate the following structure with some minimum fees and banding (tiered charges) for each category:

- 1 ½ % of new Pension money invested (or 10% of year 1 premiums)
- 2% of transferred pension advice and drawdown
- 1 % of standard investment advise (or 10% of year 1 premiums)
- 2% of esoteric advice
- 2 ½ % of IHT saved
- 5% of CGT / Income Tax saved
- 5 % of income / profit / capital protected
- 10% of mortgage and loan savings in year 1
- 10% of additional returns on savings on deposit
- 10% of savings made on other bills

At this point a client has received considerable value and may for all the right reasons elect not to proceed further at this point. In the old world an adviser would have incurred significant cost and delivered considerable value, many having also at this stage given product advice too. In the old world they may walk away with nothing and the client much more enlightened. In the fee world the adviser would be fairly rewarded to this point for the cost incurred and the value delivered, keeping the firm's cash-flow and profitability intact. The client has the choice to then have specific solutions recommended to the first stages / priorities of their financial plan for a further agreed fee.

Tactical (Product & portfolio) recommendations

Now when it comes to the product and portfolio recommendations the fee may be much more modest than of old and may even be set as flat fees.

Again for example,

- Pension product & portfolio advice £300
- ISA, OEIC product & portfolio advice £150

- Bond product & portfolio advice £220
- Long Term care product advice £250
- Trusts £150
- Lasting Powers of attorney £100
- Mortgage £300
- Income Protection £350
- Life Assurance / Critical Illness advice £350

Again these fees are payable whether the client choses to implement or not as the work has been done and the advice and value has been given.

Implementation

Then for those clients that want to proceed to implementation a small admin fee may be chargeable to cover the final administration work.

For example:

- Pension Transfer admin £150
- Pension admin £75
- ISA, OEIC admin £50
- Bond admin £100
- Long Term care admin £125
- Trusts £25
- Lasting Powers of attorney £25
- Mortgage £150
- Income Protection £100
- Life Assurance / Critical Illness advice £100

With this approach the advisory firm is paid in line with where the cost and the value is delivered and when it comes to the final stages the emphasis and weighting is less on the product and its implementation.

Advice fees for existing clients

New advice to existing clients should often come at a discount as the relative cost and value is less

- They will not incur the fact find charge unless moving to a higher level proposition that requires more discussion.
- The Strategic Recommendations & Plan charges are likely to be lower unless there is a significant change of circumstances as any new investment should be in the context of the original strategy and plan.
- The Tactical Recommendations will still apply but more often than not are likely to be top ups to existing wrappers
- Implementation costs are likely to be lower if they are topping up existing wrappers, but the same if a new product is being effected

Profitable pricing

"A cynic is someone who knows the price of everything and the value of nothing"
Oscar Wilde

In a later chapter we will look at some of the mechanics of how firms cost advice and services but I would just like to warn readers of the need to avoid measuring their new pricing against historical rates.

Chapter 9 – Choosing Your Firm's Pricing Strategy

As mentioned in the first chapter, let us not forget what has happened to costs, revenue and regulatory demands over the last 10 to 15 years.

Regulation:	*Polaristion,* De-polaristion, Commission Disclosure, Sandler, CP121, N2, Multi-Tie, TCF, RDR, Capacity for Loss, Platform Regulation
Product issues:	Endowment Review, Pension Review, Long Term Care, Payment Protection, With Profits, Stakeholder, Plummeting Annuities, Split Capital Trusts, development of on-line products, supermarkets and platforms
Provider issues:	Barings Bank & Nick Leeson, Equitable Life, numerous mergers & acquisitions, Banking crisis initial and ongoing, Enron, Lehman Brothers, Northern Rock
Market issues:	Black Monday, Dot.com bubble, 9/11, 7/7, Maxwell, Euro crisis, Banking crisis
Business expenses:	Escalating PI costs, regulatory fees, FSCS levy, Print & Stationary, Fuel, Office, Capital Adequacy, VAT rises
Consumer confidence:	Impacted by market volatility, reputational damage, gloomy long term outlook, Euro-crisis, property collapse
Revenues:	Dislike of commission – downward pressure on commissions since Sandler
Technology:	Boom in use of web, on-line tools, introduction of platforms
Consumer:	More financially aware, more demanding around service & price, higher expectations, more affluent but with less time and more stress / worries, living longer and needing more money.

As a result if a firm is offering a new proposition delivered in a different way for different purposes it really is like chalk and cheese. It may well be that the new prices charged are more expensive than previously made, even if the business is using platforms to improve the efficiency of how they deliver their advice and services.

Effective use of investment platforms facilitates a greater efficiency in the administration of client investments than traditional provider facilities can deliver. Some industry-related media comment makes an erroneous assumption that these efficiency benefits must lead to a reduction in the fees firms charge for their services. However, platform technology only has a direct impact on the element of adviser charge related to implementation and administration of the selected client investments.

The aspects of an adviser's role to which clients attach highest value involve strategic advice, tax planning benefits, on-going progress review services and a relationship where their issues are at the forefront of the adviser's mind.

Source: Investment Trends Pty Ltd. December 2005 Planner Technology Report

Therefore, the primary factor in determining the price a client is charged should not be time taken to administer products, but the value of expertise required to resolve issues that clients regard as

complex enough to warrant the engagement of a trusted adviser. It does not automatically follow that the overall charge should be lower than the remuneration a firm may already receive because that presumes the current charge was appropriate.

Achievement of a fair and healthy level of profitability by an advisory business is something from which clients should take comfort. Clients running their own business would be concerned if their financial planner wasn't operating on a profitable and sustainable basis. Businesses which only just break-even tend to be characterised by owners and staff operating under stressful conditions, which is not conducive to helping clients create and manage a meaningful financial strategy of their own.

Profit enables a firm to invest and improve its value to clients, develop and reward staff, reduce risk and maintain their ability. In fact a key concern of the regulator is the profitability and sustainability of adviser models.

Collecting fees

Many firms will collect fees from the products implemented wherever possible as this is the easiest way to collect them. However it is important that a firm makes it clear to their clients that the fees are not to pay exclusively for the product but primarily for the advice and service that has been and will be delivered.

Indeed whilst easier to collect fees this way, it may be worth considering the merits of clients paying retainers and fees directly rather than from their investments. The reasons for this are growing:

- You can only collect fees from a pension for advice that relates exclusively to the pension and so payment for on-going services and broader advice could expose the client to making unauthorised payments from their pension funds
- Payments from Bonds effected after 1st January 2013 for fees are deemed as return of capital and so will reduce the amount that can be taken tax free at a later date.
- Payment from the funds obviously create a drag on their returns
- Payment from the funds can give the client the impression that this is the main thing they are paying for, advice on the funds and product
- Payments from an ISA & Pension reduce the amount left to grow in a tax advantageous wrapper
- Payments from OEIC's can contribute towards the creation of a CGT liability, but this could be good tax planning.

If payments for service and advice are to be collected from funds it may be best to take them all from the OEIC if possible, to realise gains or crystallise losses and minimise the drain on the tax advantages of other wrappers.

VAT

I do not propose to go into any detail about VAT as the rules are always subject to different interpretations and new perspectives and applications of the rules may arise in months to come to make any comment here out-dated.

All I would say is that you should not let the VAT tail wag the dog. If the right Client Proposition and Pricing Strategy running alongside it means that clients need to pay VAT then do it. Most firms that have bitten the VAT bullet found it was more in their own minds as being an issue than in their clients. It is better to have a business that isn't subject to a huge fine in future which subsequently goes bust and therefore cannot look after its clients at all.

Chapter 9 – Choosing Your Firm's Pricing Strategy

Summary

The market needs to release itself from the shackles of old school, product and FUM based thinking, ensuring the focus is truly on the client and not the client's money. Whilst the regulator wants to see clearly defined prices for well-defined services it could do with recognising that there is an art form to pricing and as we are dealing with clients seeking a quality responsive service, peace of mind and trust these things are not commodities upon which a standard price can or should be quoted. Reality is 80 - 90% of the time prices will fall into a framework but 10% - 20% of the time there is a requirement or opportunity to flex.

If the proposition is strong, its value effectively articulated clients should see the merits of working with a pure fee based adviser who charges profitably for the impartiality they can expect and the longer term sustainability of the services they will be provided with.

A future chapter will look at the mechanics of how a firm sets its prices, but before we do that we need to understand what the Client Experience looks like, who delivers and how to establish the cost of and value of delivery.