



The Truth About Commission

As saying goes, there is no such thing as a free lunch and there is certainly no such thing as free financial advice. The vast majority of investment advisers work on a commission rather than fee basis and whilst you do not physically write out a cheque for the advice, you are paying for it out of the investment plans/policies you buy. You may be paying too much.

The argument against commission is that it may cloud an adviser's decision making and can place far too great an emphasis on selling products rather than giving sound financial planning advice. If a commission-based adviser doesn't sell you a financial product, he or she will not earn a living. This can lead to conflicts of interest and exploitation by some of the more unscrupulous operators in the financial services industry. There are some excellent commission-only advisers but equally, there are some very poor ones.

Commission and confusion go hand in hand and we would like to take this opportunity to talk you through some of the ways that you might, wittingly or not, be paying commission to an adviser.

Investments

IFA, Bank or Direct Sales

If you seek investment advice from an IFA, bank or 'direct sales' organisation, you may be recommended an investment bond (insurance bond) and some other form of investments such as ISAs or Unit Trusts.

Commission is payable in one of two ways on investments bonds. The adviser can either take all of the commission 'up front', which would normally be between 6-8% of the amount invested, or can take a reduced initial commission of around 3.5-4.5% and add 'fund based renewal' to the contract. He or she will then receive 0.5% of the fund value per annum. The insurance company will take these commission payments from the charges on your policy. It is possible for a fee-based adviser to rebate all of this commission to significantly reduce the total expense ratio of your investment.

With ISAs and Unit Trusts, the initial commission will usually be limited to 3-4% of the investment amount, with fund based renewal of 0.5% also being paid. Whilst it is always possible to reduce the initial commission, some investment houses will not allow the adviser to rebate the renewal commission.

The idea of fund-based renewal is to cover the cost of ongoing advice. Some advisers will provide this and some won't. If your adviser doesn't give you regular investment advice (at least an annual review meeting for example), are you happy for he or she to be receiving this payment?

Where investments are paying fund-based renewal commission, this can usually be transferred to a new adviser who will commit to providing ongoing advice. It is your decision.

Stockbroker

If a stockbroker arranges your investments, commission will normally take one of three forms, depending on the type of service you are on.

With an Execution Only service the stockbroker is simply following your instructions and is offering no investment advice. Commission will normally be a fixed percentage of the deal price, subject to certain minimums. If you are invested in an individual equity, no renewal commission will be payable. There will probably be custody fees but that is another story altogether! If you selected a fund, your stockbroker will probably be picking up fund based renewal commission. Were you aware of this?

The next type of stockbroking service is sometimes referred to as Advised Dealing or Dealing with Advice. Here, the stockbroker will charge you a higher level of dealing commission, normally around 1.5% per trade but will offer their opinion on the stock. Remember, you will also pay this commission when you sell the stock, which means that the cost per investment is really about 3% or more! If you are advised to use a fund, the stockbroker may also receive 0.5% p.a. in fund-based renewal commission. The custody fees will be in addition to this.

Finally, you could be a Discretionary client. You will pay a fixed fee/commission per annum of around 1% and then any deals within the portfolio will be subject to a reduced dealing commission, probably around 1%. Remember, that's 1% on purchases and 1% on sales. If your portfolio invests in unit trusts, then you'll be paying the trust manager's annual management charges including trail commission!

Directly through the insurance company / investment house

You don't want to pay for advice so you carry out your own research, make your own decisions and think that you have beaten the system. But you haven't because you have just bought an investment with exactly the same charges as you would have paid if you had taken some form of advice from an IFA!

How is this so? The reason is quite simple. An IFA is just one way in which an insurance or investment company markets its products and commission is paid for this purpose. If a client buys an investment directly, the money that would have been used to pay the IFA will be retained and used for other forms of marketing, or sales incentives for its advisers .

Discount Broker

If you do not want to pay for advice, know exactly what type of investment you want, have selected your own funds and are confident that you understand the tax and risk implications of the chosen investment, a discount broker may be your cheapest option.

A discount broker will offer no advice and will normally rebate all of the initial commission to reduce the charges of your investment. They will normally retain all or most of the fund based renewal commission, as this will be where they make their profit. If you hold your investment for the longer-term, they will still make quite a bit of money out of you. The stockbroking equivalent of this is the Execution Only service.

Insurance company products

Regular premium products such as Term Assurance, Pensions, Endowments and other savings plans will normally offer the adviser commission on an indemnity or a non-indemnity commission basis. If you are investing £300 per month into a pension, it is not really in an adviser's interests to take a percentage of each contribution as commission as the amount will not be meaningful. This is known as non-indemnity commission in that it is paid each time a premium is paid and if you cancel the policy, the insurance company will not reclaim any commission from the adviser.

Instead, most advisers opt for indemnity commission, whereby something like the first four years of commission will be paid up front, providing the adviser with a much higher initial commission. If you surrender the policy or stop paying into it, some of this will be 'clawed back' from the adviser.

If you have included automatic indexation into your policy (pension contributions increasing by 5% p.a. for example), further commissions will be paid when the premium increases.

If you are contracted-out of the State Second Pension (previously SERPS), when your Department of Social Security rebate is received by the pension scheme a further commission (probably around 5%) will be paid.

On top of these commissions, most regular premium policies will pay a small trickle of commission from the end of the 4-year indemnity period to the end of the policy – probably around 2.5% of each premium paid. This may not seem like much but it certainly adds up.

What does TWP Wealth Ltd do?

We have a clear charging structure. We do not mind how we earn this money but this is what our charge is and this is what we expect to earn. It may be more tax-efficient for you for us to take commission on any investments or insurance contracts that we advise and arrange for you. We will then rebate this against our fees. In fact we predominantly work with Providers who do not pay commission- but leave any remuneration to be agreed between you and us. Alternatively, you may prefer to have strictly commission-free financial products and pay us by Standing Order. It is your commission and it is therefore your choice.

If you seek advice from TWP Wealth Ltd, you will no doubt already have a number of financial products in place. By transferring these to our 'agency' any commission that is currently being paid to a previous advisory firm may be payable to TWP Wealth Ltd. We will disclose this to you and deduct this from your fee. At our initial meeting, we will even give you an estimate as to how much we might receive.

We hope that has given you a clear insight into the murky world of commission. Please contact us if you would like further guidance.

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