Excuse me, are you an independent adviser?

A financial adviser who claims to be so may not be telling you everything

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IT HAS been eight years since "independent financial advisers" were formally introduced to the Singapore scene.

That was when the Financial Advisers Act (FAA) became operational. Among other things, the Act defined just what an "independent financial adviser" (IFA) is.

But ask many Singaporeans, including people in the financial sector, what the term means and you will find more than one interpretation.

Under the FAA guidelines, only financial advisers who can clearly demonstrate that they do not have financial or commercial links with product providers that could influence their recommendations should use the term "independent".

Few financial advisory firms would therefore qualify as "independent" under this strict definition. Those who don't qualify are smart not to describe themselves as "independent" on their stationery. After all, they wouldn't want to risk incurring the wrath of the authorities which may result in having their licence revoked.

The problem is that some firms in Singapore give the impression that they are "independent" by saying so verbally to customers through their advisers. Typically, advisers will tell clients that the firm is independent because it is not tied to any product provider.

This loose interpretation of what constitutes "independence" is one many consumers are familiar with. It means the advisory firm can distribute products from more than one principal or product supplier.

These advisers differ from say, an insurance agent or a banking relationship manager, who sells products from only the insurer or bank that he is tied to.

Trying to brand themselves as "independent" makes them seem pro-consumer as they would appear to have little incentive to hard-sell or push specific products. This would suggest that their recommendation is based on clients' needs, not their own commission.

But are advisers really "independent" just because they are free to market products from different product providers?

The answer is no. Let me illustrate why this is so.

Many consumers know that financial firms are paid a sales commission for products they sell, say, an insurance policy or a unit trust fund. This commission is often stated upfront to the consumer upon request. As it is often a standard rate, consumers are free to buy the product from any firm.

But there is another type of commission that is not well-understood. This is the volume commission or bonus given to financial advisory firms for hitting a certain quota of sales and renewals of specific products. This volume bonus can amount to millions.

For example, some insurers are known to pay volume bonus in advance, in return for the financial advisory firm's commitment to deliver a certain amount of new premiums from sales of specific policies over a specified period. The volume bonus may be clawed back if the sales targets are not met.

Firms that engage in this practice may create an incentive for their advisers to steer customers to buy a specific product not because it is suitable for them, but because the firm or adviser wants to meet the sales quota to get the extra volume commissions.

This is particularly so when volume bonuses have been paid upfront and the firm is obligated to deliver a certain volume of sales.

These bonus commissions are typically hidden from consumers and pose a more insidious threat to independence than standard sales commissions.

Such commissions are by no means rare in the industry. Some firms tied to such monetary schemes can still convey the impression that they are "independent" in that they are not tied to any particular provider.

Yet such firms clearly have financial incentives to recommend products to clients to meet sales quotas, not for their clients' interest. If the volume bonus is big enough to influence an adviser's recommendation and steps are not taken by the firm to avoid product bias, the adviser and his or her firm could be in violation of the FAA.

Short of banning volume bonus, which can be one solution, the authorities have to step up their audit checks to ensure that the term independence is not being abused. Clearer guidelines on what constitutes independence are needed, as well as a list of unacceptable practices.

Financial advisory firms should also be strictly audited to ensure that advisers meet Fair Dealing guidelines and have made proper disclosure. These guidelines state that the financial adviser must sell a product that is best suited to a client and not sell the policy that earns more commissions.

Consumers Association of Singapore executive director Seah Seng Choon said advisers who do not disclose fully their benefits are not acting in accordance with the Fair Dealing guideline.

He also wants financial institutions to take steps to make sure the "volume bonus" incentive does not skew their advisers' product recommendation.

One firm here takes its independent stance seriously, operating as a "fee-only" practice. This means it is paid solely from client fees, typically an annual retainer calculated as a percentage of the total portfolio managed by the firm.

It does not keep any form of commissions from product manufacturers to avoid potential conflict of interest. This firm will in fact rebate such commissions in full, less the administrative and Giro fee, to the clients.

But many other firms may simply keep mum about commissions and pocket them.

With so many grey areas surrounding the issue, it is no wonder that some countries like Australia and Britain are planning to ban all sales commissions for products sold by financial advisers, or at least make them more transparent to customers.

Till that happens in Singapore, customers here should be aware that there is more than meets the eye when an adviser claims to be "independent". At the very least, the savvy client should ask: What about volume bonus?

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