The right price for advice

Financial advice for complex investments can be costly, even if some advisers tell you it's free. We look at how to avoid paying over the odds

DON'T CUT OUT THE MIDDLEMAN

Tom McCullough *39, chartered structural/civil engineer*

In June, Tom was looking for a stakeholder pension (see 'Save now, live it up later', *Which?*, June 2007, p27).

With most providers, the charges remain the same whether you buy direct without advice or you go through an adviser who is paid by commission. But if you choose instead to pay by fee, and ask your IFA to give up commission, this has the effect of reducing the product charges and increasing your long-term return.

For example, for a £100-a-month premium, assuming 7 per cent growth, Best Buys Scottish Widows quoted a fund of £91,900 at age 65 if Tom bought the pension direct, but £97,400 if he went through an IFA who rebated the commission. Standard Life quoted £87,800 if he went direct and £97,800 through an IFA.

Tom could expect to pay a fee of £300 for the advice. Even invested, with the same growth rate and deducting charges, this would give only about £1,300 at retirement. So he'd be better off by more than £4,000 with Scottish Widows and £8,000 with Standard Life by using an IFA.

Tom told us: 'I would have expected it to be cheaper to go direct, but it seems that cutting out the middleman would have proved costly.'

Financial advice is not cheap, but in many cases it's a must. While Which? Best Buy tables will probably suffice if you're looking at simple products such as cash Isas, most people will probably need to pay for professional financial advice when considering share-based investments, such as unit trusts, a pension, mortgage or a protection product. Unfortunately, the amount you should pay is less obvious.

Unclear quotes

Earlier this year Which? conducted mystery shopping research into the quality of advice provided by financial advisers. The results were disappointing; more than half of our advisers failed our tests (see 'Financial advisers in the spotlight', *Which?*, October 2007, p34).

Despite a legal requirement to ensure that you are given a clear indication of how much you'd pay for advice, 82 per cent of advisers failed to give our researchers a precise explanation of their payment structure.

We carried out further research among independent financial advisers (IFAs), asking them questions about paying for financial advice. Many found it difficult to tell us how long it might take to give advice on standard investments, such as stocks and shares Isas. It seems many IFAs are unable to provide an accurate quote – and yet that is exactly what you need in order to work out whether you should pay by commission or fee.

Commission

Commission is paid for out of product charges. Different providers and advisers will charge differing rates of commission, even for the same products.

For example, the IFAs we visited as part of our mystery shopping charge between 3 and 8 per cent of the initial investment for a unit trust. Most also charge between 0.5 per cent and 1.5 per cent of the value of the investment each year as renewal commission. The banks charge between 2.6 per cent and 8.2 per cent as initial commission. Some also charge between 1 and 1.3 per cent as renewal commission. This means you pay anywhere between £260 and £820 initially on a £10,000 investment, for example, and between £260 and £1,550 if you were to hold the investment for five years.

For personal pensions, IFAs charge between 20 per cent and 79.3 per cent on the first year's payments as commission. Banks charge between 13 per cent and 56 per cent. This means that on a pension of £100 a month you would pay between £156 and £951.60 in commission.

Paying by commission may be tempting because you don't fork out a lump sum

Advisers explained

The differences between the three types of financial adviser

- **INDEPENDENT FINANCIAL ADVISERS** These must offer products from the whole market and must offer payment by fee. They can also offer payment by commission.
- **WHOLE-OF-MARKET ADVISERS** These differ from IFAs as they don't offer a fee option. Consequently they cannot call themselves independent either in their name or their literature.
- **TIED ADVISERS** These recommend products from a limited number of providers or from just one provider. They don't have to offer a fee option.

upfront. But it can affect the long-term return on your investment, so the total return on an investment can be reduced substantially because part of your money is being used to pay commission rather than being invested.

If your IFA tries to push you down the commission route, you should insist on an estimate of how much the fee would be. If a product is later recommended, you can then ask your adviser to give you two illustrations, one assuming the advice is paid by commission, the other assuming no commission is paid. With this information, and a fee quote, you can make an informed judgment about how to pay.

Fees

The variation in fees between different IFAs is immense. Our research revealed that IFAs charge from less than £50 to more than £400. The fee range is due to such factors as location, size of the consultancy, an individual IFA's qualifications and expertise and the size of investment. However, even an expensive adviser's fee could prove much cheaper than paying by commission.

Fees versus commission

Commission-based advice can be dressed up to appear free, even though it is often more expensive than paying a fee. Bank advisers might tell you they provide free advice but they don't. The cost of advice comes out of the product charges. Similarly, IFAs who offer commission aren't providing their services free, despite one telling our mystery shopper 'most people are happy for us to work on commission because it's paid out of the product,' and another saying 'as far as you're concerned, you're not really paying for advice.'

The variation in fees between different IFAs is immense

Both statements are potentially misleading, as commission can raise the product charges, which dramatically affects the return on your investment long after you have taken the advice (see the graphs, left, for examples of how costs can differ if you pay a fee or by commission).

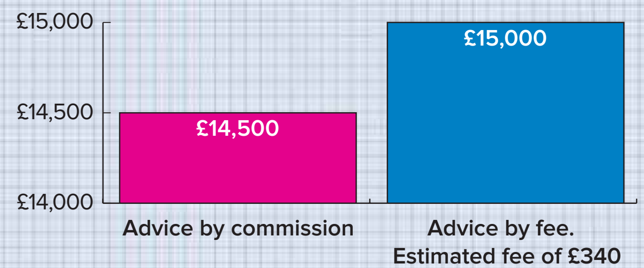
Negotiate

Around four fifths of the IFAs surveyed revealed they would take less commission than quoted in their pricing literature, making it important to negotiate when you come to discussing payment.

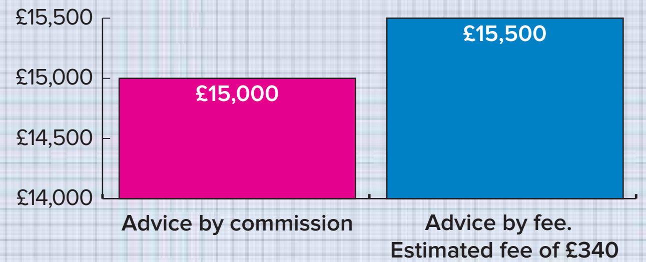
Their reasons for doing so can be vague. For instance, a Midlands-based IFA revealed it is willing to lower its charges 'when the commission is disproportionate to the

THE COST OF ADVICE IN FEES AND COMMISSION

The graphs below show how you get a greater return paying by fee than by commission (left-hand column). The right-hand column shows the return on £10,000 invested with no deduction for the cost of advice – instead, advice is paid separately by a fee of around £340. Remember: the more you invest, the more commission you pay, whereas the fee usually stays the same. The graph on the right shows the savings made on insurance products when paying by fee compared with paying by commission.



£10,000 lump sum (in unit trust/OEIC). Return after ten years assuming a growth rate of 6 per cent a year



Stocks and shares Isa. Return on £100-a-month investment assuming a growth rate of 7 per cent a year

Income protection insurance. Quote for a non-smoking male, 40 next birthday for a 25-year term

Key for insurance and income protection below
- Cost over 25 years: commission basis
- Cost over 25 years: including fee for advice of £420

PHOTOGRAPHY APEX PHOTO, ROB UNDERDOWN

work involved'. Another, from the Northwest, said it always lowers its charges because 'we just do, always have done. Don't know why really.'

IFAs may be willing to negotiate how their fee is paid, so a large lump sum could be split into instalments, or an hourly fee could be paid for each consultation.

To make matters more difficult, the requirement to use Key Facts documents, which show different payment options and the cost of advice, has been phased out. According to our research, the decision to remove the documents has split IFAs, with 31 per cent considering it a positive move and 30 per cent viewing it as negative.

For each one who welcomed the decision with comments such as: 'It's about time someone trusted us and let us get on with the job', another told us that removing the requirement to produce Key Facts documents would 'only make it less clear how much customers should expect to pay'. A quarter of the IFAs surveyed felt the solution was to replace the Key Facts with a discussion between the adviser and client.

We think removing the Key Facts documents was a mistake. Advisers still have to explain their charges, but without the standardised documents it is now even easier for them to skirt around the payment issue.

Straight talk

With Key Facts documents gone, it is even more important to ask the right questions and get clear answers. Have a clear idea of what you want to invest, what your view on risk is and how much you're willing to pay for advice. In addition, clarify whether an ongoing service will be provided and how much it will cost. The results of our research underlined the importance of being firm when dealing with IFAs.

Shop around and insist on quotes for fee- and commission-based advice. This is the only way you can expect to see exactly how much the advice would cost.

You should treat a quote from a financial adviser in the same way you would one from a builder. After all, you wouldn't have an extension built without giving the contractor a clear idea of what you wanted and without getting a written estimate. The same applies to financial advice. If an adviser is evasive about fees, beware.

There are good IFAs out there who will give you quality advice for a fair price. You may just have to hunt around to find them.

Expert opinion

We ask an Independent financial adviser for his thoughts on the thorny issue of paying for financial advice

Dr Robin Keyte of Towers of Taunton (Financial Services) is an IFA who provides exclusively fee-based advice.

He believes that consumers need to do their homework and have a clear idea of what they want from an adviser; have a maximum cost that they will not go beyond under any circumstances; and should be prepared to challenge any expenses set by the advisers. After all, it's not the advisers' money, it's yours.

Dr Keyte explained: 'Consumers should be more streetwise when it comes to dealing with IFAs. They should have a cost in mind, stick to their guns and negotiate hard. The actual amount that they pay should depend on whether they are starting from scratch and seeking full and detailed financial advice, or simply requiring the IFA to arrange a specific purchase.'

MEMBERS' MONEY

Be advised

Financial help from Which?

Our book *Be Your Own Financial Adviser* will show you how to identify your key financial goals and avoid unnecessary risk, creating a plan to meet all your financial needs. To order a copy at the special price of £10.99 (£1 off the RRP plus free p&p), call **01903 828557** or email your details to **mailorders@lbsltd.co.uk** and quote FAW1107 and ISBN 978 1 84490 012 1.

Checklist

Top tips on getting the right price and adviser

- **DIY or IFA?** Use Which? Best Buy tables for basic products (such as cash Isas) and IFAs with more than three years' experience and more than the minimum qualifications for investment, pension and protection advice. See www.which.co.uk/money for more information.
- **Capital costs** According to our survey, London IFAs tend to quote relatively high average fees, so it may be worth Londoners approaching provincial advisers.
- **Recommendations** Ask friends and families for their recommendations. Also see www.which-local.co.uk or www.unbiased.co.uk.
- **Negotiate** Have a top price in mind, stick to it and haggle with the IFA. Negotiate over the phone if you find it difficult to do face to face.

OUR RESEARCH

In May 2007, we contacted 21 IFAs and 19 tied financial advisers as part of a mystery shopping exercise into the quality of financial advice.

In July 2007, we surveyed 231 IFAs throughout the UK by telephone. Quotas were set on the size of the IFA firm, region and area of specialisation. We also contacted Abbey, Barclays, CIS, Halifax, HSBC, Lloyds TSB, Nationwide, NatWest, RBS and Yorkshire and asked about the costs of their advisory services.

Contacts

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