Towards fee-based pricing for investment business?

Exchange-Traded Funds to be a major catalyst

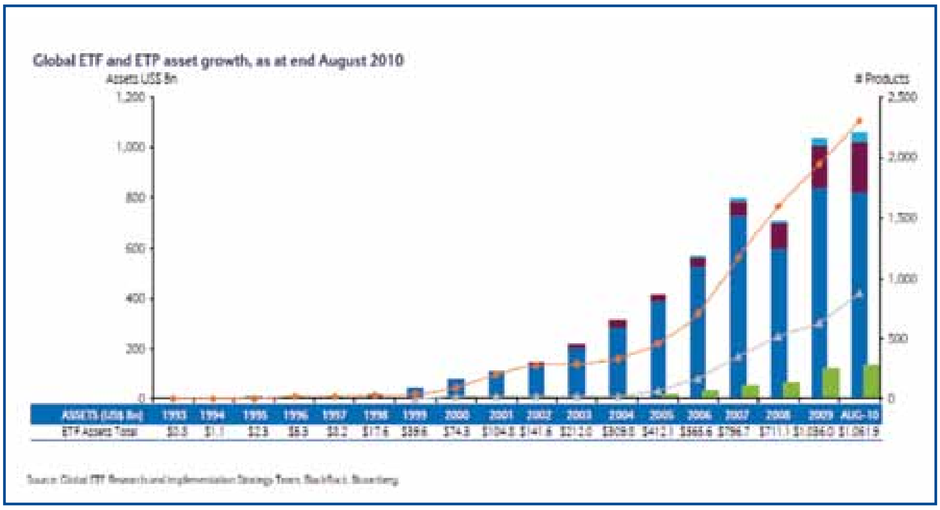
Would your business be very different if commission was banned? Although this is precisely what is going to happen in the UK in 2013, most brokers I talk to seem absolutely convinced that we will not follow suit. While there could be an element of wishful thinking / 'appalling vista' at work here it has not been the Irish way to spring such change without a lot of consultation and prevarication. So, why am I suggesting that more investment business will and should be done on a fee basis now?

Firstly, the level of trust in many providers of investment services has never been lower. This opens significant possibilities for brokers who have maintained good relationships and who can improve and adapt their proposition.

Secondly there is a focus on costs and value like never before. Especially as more and more people become aware of Exchange-Traded Funds ("ETFs") they have a reference point in terms of value which severely challenges mainstream funds. Exactly why is a unit-linked fund which invests in Eurozone bonds (with an annual management cost of 1%) better than an ETF costing 0.20%?

It has been quite normal for the more affluent clients of many brokers to have some or even most of their investments with a stockbroker and/or private bank or simply spread around several providers. As well as having a certain 'cachet', people believed that the likes of stockbrokers and private banks had specialist expertise and access to the best products. For whatever reason, these relationships have for many people been neither happy nor beneficial and yet a lot of such relationships continue to limp along. Is it simply inertia or has no one presented a viable alternative?

You may now be the adviser who is best placed in terms of relationship/ trust –however you will probably need to strengthen your know-how in the investment area in order to be a credible alternative. Such expertise can be bought in and with the right help at your side you can take on all comers! However be aware that people used to dealing with 'non-broker' providers have little time for the system of allocations/surrender penalties and are likely to have a strong bias towards a fee (even though this may be taken wholly or partly in the form of commission).



Even if not motivated or sufficiently confident to go after assets in the care of more 'specialist' providers, imagine another real world situation –you have a good connection to a local Lotto winner. Unlikely as it may seem, you are in competition with another broker who (horror of horrors) uses a mixture of ETFs and life company funds. Since he/ she can demonstrate that the cost to the client is 30-40% per annum less than the portfolio you are recommending, you are likely to lose out. This will be despite your very best efforts in terms of securing the best allocation rates and paring your commission.

Some brokers rule out ETFs because they are not within the scope of their authorisation. Well, the fact is that they are not terribly exotic and trade just like shares - a number of our clients who are Authorised Advisers have had their authorisations extended to cover ETFs without undue difficulty or delay.

The more that brokers deny their existence the longer it will take for ETFs to arrive on 'Main Street', but arrive they will. Together with their 'first cousins' Exchange-Traded Products ("ETPs") they have been a rapidly-growing, global phenomenon, as the chart above shows.

It may continue to be a minority of clients who are aware of them (and for whom they may be suitable) but knowing about them is going to be a necessity for any broker who aspires to compete properly in the investment area. A word of warning – while relatively simple, ETFs/ ETPs are quite different to unit-linked funds in terms of legal form/domicile and can be subject to different tax regimes. They also come in a variety of forms (e.g. swap-based or replication/distributing or accumulating)- in short, looking them up on Google won't be enough!

Having understood ETFs/ETPs, embracing them requires the major leap of adapting how you get paid and perhaps being happy with a smaller part of a bigger pot. With ETFs/ETPs available to be used as part of the solution you bring, go out and look for (what is left of) the assets clients entrusted to other investment providers and compete with confidence for new, bigger cases!

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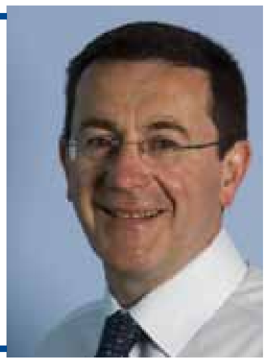

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