

OPINION

Who are you calling independent?

Who counts as an independent financial adviser? Let's spell out some clear boundaries so as to protect the investing public.

By David Choo

The saying goes that there is no shortage of advice and advisers – only a shortage of sound advice and independent advisers. The implementation of the Financial Advisers Act (FAA) will usher in a new era for the financial services sector in Singapore. Therefore the crucial questions are what major improvements will we see, and how will consumers' interests be better served?

Removing the boundaries that separated banking, stockbroking and insurance business in the past will create the common turf for a more open and competitive financial services sector. That means product manufacturers can now diversify, but the major impact will be felt in the area of distribution. Product manufacturers will have the option of using agents, brokers, banks and the Internet, as well as their own staff. Consumers, in turn, will face a similar choice.

The FAA uses the term “financial adviser” in a general way to encompass insurance agents and the representatives of brokerages, banks and stockbroking firms. The Financial Advisers Regulation permits life insurance companies to carry and distribute the products of other life insurance companies. Exempt firms that offer financial advice – banks and stockbroking firms, for example – can also set up Financial Adviser (FA) firms.

Whether a life insurance company actually decides to carry another firm's products will depend on many factors,

and not all are favourable. For one thing, it would be an admission that it does not have all the best products or a complete range – the very point brokers have been making. Small firms with competitive products would stand to gain more, probably at the expense of the bigger firms with not-so-competitive products.

If life insurance companies do set up FA firms, perhaps to dissuade their agents from leaving, it will depend on whether there is any added value. If these FA firms are not really “independent” – and by the normal understanding of the term they would not be – then there is no advantage. In fact, “corporate agencies” set up by managers to represent life insurance companies rightly have to apply to be FA firms, but since no representative can contract with more than one FA firm, and no agent can contract with more than one principal, this presents an obvious problem.

Without independent advice, consumers need to contact various tied agents – often several times – to compare products and services before making a decision. This is why the tied agency system is inefficient, because it ties up human resources instead of freeing them.

The three criteria outlined in the consultation paper preceding the FAA regarding the use of the term “independent” are:

- the Financial Adviser does not receive any commission or other benefits from a product provider which may create a product bias
- the Financial Adviser operates free from any direct or indirect restrictions relating to the product recommended
- the Financial Adviser operates without any conflict of interest created by connections to, or associations with, product providers



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The focus of these criteria ought to ensure that an independent financial adviser (IFA) is not restricted in any way and does not have any financial reason to side with one product over another. But an IFA should also be able to offer a wide choice of products, otherwise one could qualify as an IFA by simply offering a choice of two insurers or fund managers. An IFA should also be able to provide adequate market information to prospective clients, even if the FA firm is *not* distributing the products of a given manufacturer.

Ideally, all product manufacturers would agree to have their products compared freely with the rest of the market. The idea of marketing financial products like a brand, with all kinds of inducements, does not help improve transparency or protect clients from wrong choices. Based on the three criteria, it looks like tied agents would not be able to call themselves IFAs and neither would firms that are also product manufacturers.

The virtues of the independent provision of advice, products and services are clear. When big companies select general insurance, they call for a tender in order to secure the best terms. When an individual purchases life insurance or any other investment product they can't do that, but an IFA can achieve the same end by doing some homework and

comparing different products. Clients stand to benefit since they can reasonably expect objective, unbiased advice and competitive products from those who are, by licence, able to source from a number of providers. Clients can demand that IFAs provide what is “best” for them, which you wouldn't necessarily expect from tied agents.

IFAs should also save consumers a lot of time and prevent a lot of mistakes. Without independent advice, consumers need to contact various tied agents – often several times – to compare products and services before making a decision. This is why the tied agency system is inefficient, because it ties up human resources instead of freeing them. When Singapore goes the way of IFAs, one may need only a fraction of the total sales force. In both the UK and Australia, the number of tied agents has declined substantially with the rise of IFAs.

We can also hope for keener competition amongst product providers. Because tied agents can only sell their own company's products there are no comparisons with other plans, and product providers can hide inefficiencies. Indeed, this is still largely an imperfect market and consumers do not know what is available because, for obvious reasons, tied agents do not properly enlighten them with regard to what the market offers. As a broker, I'm often asked, “How come the big insurers' products are not as attractive as the smaller insurers' products?” Granted, there are many factors in any buying decision, but a more open system of IFAs can only enhance competition and improve what's on offer.

Of course IFAs can only be as independent as the product manufacturers allow them to be. The day when all product manufacturers are willing to distribute their products through IFAs, and when all IFAs adopt a truly professional and objective way of planning and advising, will be the day when IFAs can claim to be truly independent. Don't, however, expect this day to come any time soon. Tied agencies have served insurance companies well and still dominate the distribution system, despite their high costs.

But discerning and well-informed clients will demand choice and objective advice. IFA firms will need to distinguish themselves by not only offering a wider range, but also by improving their financial planning, advising and servicing. One strategy would be for IFAs to specialise, carving different niches and moving upmarket to provide more value-added service for their clients. **SI**

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