FINANCIAL ADVISORY - THE WAY FORWARD UNDER THE NEW REGIME

With a spurt of regulations on a global level in the Financial Advisory space, following a world-wide crisis, regulators in India also are geared up. Here is an understanding of the same and take away for Financial Planners.

Brijesh Dalmia, CFP[CM]
Director, Dalmia Advisory Services Pvt. Ltd.

A lot happened in the last quarter which will change the landscape of financial product distribution in India. Firstly, SEBI eliminated entry loads in all mutual funds schemes. Then came the directives from IRDA capping the cost in ULIP's which will definitely put pressure on agent commission. If this was not enough, The Swarup Committee released its Consultative Paper on "Minimum Common Standards for Financial Advisers and Financial Education", which talks about eliminating commission from all financial products going forward.

The underlying rationale for these directives and recommendation is to empower investors and remove conflict of interest from advisory and distribution of financial products.

Barring exceptions, most human mind is programmed to remain in the comfort zone. When good things happen to us, we enjoy and never ask why? But when we face some un-favorable situations, we are upset and respond differently. We say – "the timing was wrong", we wonder – "Why me".

Today, millions of intermediaries involved in distribution of financial products in India are asking one question – "Why us".

What this means

While it may take a while for all financial products to go commission-free, the writing has been on the wall that some products will definitely become commission-free in the near future and there will be drastic cut in commission rates in other financial products. This clearly means that it's only a matter of time when a distributor of financial product will not survive unless a fee is charged from the client.

Impact

Over 3 million agents will be impacted with these regulations going forward. No-doubt, all of them may not have the level of competency to charge a fee from client. As such, a large number of agents will be forced to exit this profession and look for alternate business / job options. In most cases, new regulations are initiated with an expectation of long term positive results. Unfortunately, each time there is a change and each time we move forward, a segment of market participant lose out and are left behind. However, this also means that it will open up huge opportunities for those who upgrade and prepare themselves for things to come.

Entry Barriers

There were no entry barriers in financial product distribution and advisory till now. The only thing required to get into this profession was a mere thought of starting it. With some close relatives, friends and references, distribution of financial products usually made money from the first month itself for new entrants. However, things will be different going forward. Charging fee from clients will not be easy without experience and it may take years to break-even in the Financial Planning and advisory business for new entrants. This will ensure that only serious new players will enter into this profession from now on.

Direct Tax Code

Currently, there are several tax incentives in India on savings & investments. Concessional rate of tax under capital gain is expected to go away. Exempt Exempt Exempt (EEE) system of taxation is proposed to be converted to Exempt Exempt Tax (EET). This will have radical impact on the way investors save and invest money. Under EET, many short term investments will lose their shine due to unfavorable tax structure. The advantage of deferred taxes will induce people to remain invested for long term. This will shift the focus from product to planning for most investors. Needless to say, intermediaries who do not possess the skills to understand client's overall position and recommend products keeping taxations in mind will find it difficult to survive.

Will the client pay fee

It is like questioning whether a patient will pay a fee to a doctor for advice. The choice remains with the patient whether she needs the doctor advice or not. If she is capable of managing her cure all by herself, she may not need the service of the doctor. The doctor never calls the patient and offer advice. Besides, there are several medicines which are available 'over the counter' without a doctor's prescription which can cure minor problems. This in no way can eliminate the need of a doctor for the masses. The customer must have the choice and in personal finance also they must feel the need of the advisor for them to pay a fee. Yes, many smart investors may have time, ability and the will to do it all by themselves. But the majority of investors will still need a professional's help to manage their finances. With no other option than to pay a fee, they will sooner or later come to terms with reality and negotiate the fee structure with the advisor. An average investor needs handholding when it comes to investing. With thousands of schemes, volatile markets and servicing issues, they will need help of a professional advisor. Even when direct applications were allowed at zero entry load in Jan'2008, it did not impact the industry much as not many investors went direct. The human touch will always be needed by investors in the area of personal finance.

Sustainable business model

The speed at which information is travelling, the way technology is evolving every day, it is making most of the businesses commoditized. As such, it is not enough to make sufficient money in the short term but in order to remain in business, it is equally critical to have long term sustainability of the business model. Rather than taking a long term view, many intermediaries will try to find a short-cut to remain in business in the near term. For eg. there is already a buzz in the market to charge transaction based fee. What this model essentially suggest is that the customer decides on the product and takes the service of the intermediary to buy the product. While big distributors, banks and organizations with great technology platforms can sustain in this model, there is doubt as to how many retail agents and distributors, with limited client base, can carry on with this model in the long term. In these difficult times, in order to protect revenues from falling, many mutual fund distributors are putting their energy into selling fixed deposits and other financial products which are still lucrative to them. What they are not realizing is that they are wasting crucial time while others are preparing themselves for the time ahead. Client loyalty will be one of the crucial factors for sustained long term viability of the financial advisory profession. It is therefore recommended that advisors should identify their strength and work on a long term sustainable business model rather than looking for short term gains.

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Global scenario

India is not the only country undergoing such change. Similar regulations are already prevalent in Australia. United Kingdom has recently proposed to eliminate commission from financial products with effect from year 2012 , New Zealand is also in the process of effecting similar changes. Change may not always be welcome in the short term. There are concerns about the growth of the industry given the low level of understanding and interest among the investing public in India. But if other countries in the world already have such regulations or are moving in this direction, it clearly means there is a growing concern of conflict of interest between advisor – client relationship.

The way forward for advisors

Accepting the change is the first step towards a bright future. It is not something that has happened to an individual or a select group of people. This regulation will impact all intermediaries involved in distribution of financial products in India. The industry is not going to die off. New paradigms will open up. Things will evolve over time. Being positive and remaining in business will itself open new doors. Knowledge enhancement will be the key for long term growth.

Factor	Distribution oriented	Advisory Oriented
Paradigm	Sales	Planning
Client Loyalty	Low	High
Focus	Product	Client
Major Revenue source	Commission	Fee

As the famous saying goes – "there lies an opportunity in every crisis", this is one crisis which can open the doors for a long-term, respectful and rewarding career for people who stay.

Conclusion

Change is often difficult to digest. But looking at the brighter side of any change is far more effective than having grudges against it. India is a country where investment products are primarily sold than bought. With distribution not being lucrative anymore, the regulations will have its impact initially as agents may not approach investors for savings & investments and investors may not come forward themselves. However, we need to move forward and beginning has to be made somewhere and the new regime is the beginning for a more matured and sustainable market place. All this will not happen overnight. It will take some time for things to settle down but it is definitely the beginning of a new era benefitting all the participants involved in the long term.

brijeshdalmia@gmail.com

FPJ