

## Am I the Client or is it My Money?

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How planners and institutions absorb the notion of fiduciary and express it in the engagement with the community will determine whether financial planning becomes a profession. A profession that delivers all of the personal satisfactions and rewards that generally go to those individuals that the community recognises as delivering a valued personal service. The critical change required is the elimination of any perceived conflicts of interest.

### Potential for Good: The Circle of Virtue.

Financial planning for Australians and their families grows ever more complex and demanding. The transfer of responsibility for retirement funding and investment risk taking to individuals increases daily. Personal responsibility for difficult decisions is thrust upon many who are ill prepared for them.

Helping individuals and their families think more clearly and behave more responsibly with their money promises significant enhancement in their ability to define and navigate their life. This is not a standalone benefit. There is an accelerating cycle of virtue generated through the improvement of financial behaviour.

- ❖ A personal sense of well being by having, at least, the financial part of their life under control.
- ❖ Individuals and their families become better protected from the vicissitudes of life through savings and appropriate insurances.
- ❖ Individuals and their families become more financially self-sufficient thus needing lower levels of community support.
- ❖ The better matching of financial products to needs leading to higher persistency and consequential profitability for their manufacturers.
- ❖ The creation of national wealth pool that reduces the need for offshore borrowings and investment funds.

With all these benefits in play it makes enormous sense for there to be the utmost confidence in the integrity of those who deliver financial advice.

### So what am I looking for?

We will live longer than our parents. In addition, we cannot rely on our actuarially determined life expectancy as the basis for funding our future requirements. It is increasingly obvious that we must be prepared to finance a further 10, 20 or even more years. As a result, traditional retirement savings for many of us are likely to be grossly insufficient. And because we have been forced to personally take responsibility for funding and managing our retirement moneys we have, in many cases, a desperate need to optimise the power of our total asset pool.

We just cannot afford to hold lazy assets or manage them tax inefficiently, be they our earning capacity, our home, our investments or our pension. Decisions like this mean we must be certain that advice given to us has no trace of conflict.

Over the last 3 years I have explored two product solutions to access equity in the family home without a full sale: reverse mortgage and part sale. I have analysed the application of each, their risks and the overall benefits.

The analysis shows that reverse mortgages work well when:

- ❖ interest rates are low and/or declining.
- ❖ the amount accessed is relatively small- less than 5% of a homes value.
- ❖ the borrowing term is relatively short.
- ❖ when house prices are escalating.

Part sale is generally better when home owners want to avoid interest rate and longevity risk and diminish their exposure to the home. Part sale works well when:

- ❖ house prices are stable or diminishing
- ❖ the amount accessed can be relatively large – say 20% plus of homes value
- ❖ the term is relatively long – say 5 years plus.

Some might say that home equity release is a last resort policy. However how can you call yourself a financial planner if you leave a client with an illiquid depreciating asset as their major resource at the time in life when they are least able to make decisions? At the least home equity release should be regularly discussed with clients.

### What I want from my planner.

I expect our planner to give us good counsel on our potential longevity, so we have a realistic planning horizon. I expect advice to be based on our unique circumstances, assets, liabilities and needs. For instance we want to be able to talk about equity in the family home and our inheritance expectations.

I expect that our planner will assist us in understanding our financial risk tolerance, and that of my partner, and help us take it and any differences into account in our decision making. And of course we need help to understand the differences between our risk tolerance and the risk needed to achieve our goals. On top of this we expect our planner, at the very least, to help us understand our risk capacity.

We understand that there are four base components or trade-offs in any financial plan.

1. Time - Time spent working or in retirement. Time working full time or part time. Time employed or in our own business. **Our responsibility.**
2. Money - Spending and saving. Our lifestyle now versus our preferred lifestyle in the future. **Our responsibility.**
3. Insurance - Whether we self insure or share the risk with an insurance company in exchange for a premium. **Our responsibility.**
4. Financial risk in the plan - The amount of risk we would normally choose to accept in pursuit of our financial goals. **Our responsibility.**

I want our advisers to share with us their knowledge and experience as we negotiate the trials and tribulations of our major trade offs. I want them to help us design our financial road map. But only after we have decided on the vehicle, the speed we are comfortable to accept and the destination. We will take responsibility for that.

I want our planner to take responsibility for estate planning, tax, super and social security advice and the pursuit of any investment alpha we jointly agree on targeting.

I want our financial planner to have available the full range of investments including life time annuities.

Most importantly I need to see that our planner's involvement is so meaningful that we both value and pay for it up front and ongoing.

In essence I want the planning to be a collaborative process with clear responsibilities.

### Clear process for asset allocation.

More than anything else I am not interested in portfolio astrology such as the five question quizzes so beloved of compliance managers. The ones that give reports like "you are an Aquarian investor; you like liquid investments, new floats and holidays by the sea." Other than there being a one in 12 chance that the investor is actually an Aquarian this stuff is pure pap and should be consigned to the rubbish heap where it belongs.

I want something that reflects my needs; both psychological and financial. That takes into account the differences between me and my partner and gives us a clear set of decisions. Do we want to invest consistent with our risk appetite or to achieve our financial goals.

In making portfolio recommendations my planner needs to have taken into account and show the resolution between three competing risks: the financial risk that I need to achieve my goals, my risk capacity and my risk tolerance. For example: I need 100% exposure to growth assets to achieve my goals. However I could afford to lose no more than 10% of my assets with out having my life markedly changed and I have a low risk tolerance which, all else being equal, would lead me to maintaining growth assets in my portfolio of around 35%. This of course assumes that there is an inherent integrity in the portfolios constructed and there is no need for an annuity.

Clearly there are 3 different asset allocations leading to 3 distinctly different lifestyle outcomes in play here. Which is the right one for me? Which are the options that cause me the greatest and the least anxiety? What is the right way to proceed recognising the substantial differences in long term outcomes? Who should make those decisions: the planner or me? The answer is clearly me, because ultimately it is me who has to live with the result of the decision. Obviously I need the advice and input of my planner to illuminate the consequences of each option. In fact this trade-off is one of the critical components of subsequent plan reviews and the basis for my long term relationship with the planner.

Risk tolerance is the quickest and easiest of the 3 risks to assess accurately. A psychometric assessment, which has been proven to be the only methodology to deliver defensible, academically rigorous results, would take less than 15 minutes to complete. Financial risk tolerance should never be mistaken for risk needed or risk capacity. The former is a psychological trait the last two are financial constructs. Armed with a robust risk tolerance assessment the planner has a firm foundation of the client's needs at the start of the risk trade-off decision process. The other two are then a matter of financial illustration, comparison and discussion.

### **Who am I?**

I am from a cohort who will increasingly demand a fiduciary service from those who assist us with our financial plans. We tend to be more controlling and less trusting than our parents. We are both worldly and financially literate. We are cynical of all marketers' intentions.

We can access financial information easily through the media and internet. We seek advice when we need it, act alone when we want to. In particular, we are extraordinarily sensitive to the possibility of conflicts of interest that may be inherent in any advice that we seek. And to top it off we are somewhat disinclined to pay more than we believe a service is worth.

The generation before us tend to be 'delegators', with a lower need for control of their finances. They are generally happy with the paternalism inherent in the traditional style of financial planning. They have been largely comfortable with the remuneration structure that has evolved. We on the other hand are increasingly demanding an entirely different engagement.

Our financial choices are far more complicated. We are more likely to make decisions ourselves. We tend to rely on 'experts' only to validate our views, not to make decisions on our behalf. We are far more likely to be Validators. We come with a long tradition of transactional advice, be it from our lawyer, doctor or accountant, paid for once only. This is our experience of a fiduciary relationship.

- ❖ We don't expect our doctors to receive 5% of the cost of any long term prescribed drugs.
- ❖ We don't expect our lawyers to charge 3% of our estates value each year after they draft our will.
- ❖ We don't expect our accountants to charge 10% of our profits when they prepare our annual accounts.

### **What we expect.**

In traditional financial planning, clients go to planners for the things that planners know, take the planner's advice and pay the planner. This is entirely consistent with the way we deal with other fiduciaries. However, there is one critical and significant difference. Payments to planners generally continue long past the initial advice, although this is typically the planner's most significant contribution. These payments are built into the ongoing cost of managing the investable assets and are paid for over the life of the investments.

Some argue that trails are necessary because many prospective clients can not afford the high cost of advice. This may be true. However in many cases the trail is so large that it massively dwarfs the entry cost forgone. If we were to

apply financial rigour we would see that the effective interest rate used is often usurious. The trails are an opaque conflation of ongoing servicing costs and an unconscionable financing charge for the often 'free' initial advice.

If the amount charged is a function of investable funds then this is clear evidence that the whole process of planning is product centric. It raises the fundamental question - who is the client - my money or me?

Charging a client a fee based on their investable assets is a fundamental contradiction to a fiduciary and professional relationship. No one can tell whether the advice is to create more income for the planner or not. As a consequence it is easy to understand why so many prospective customers, regulators and the media are suspicious of the motives of financial planners.

A December 2006 US court case is a good example of how one community dealt with an unreasonable financial charge. People of the State of New York represented by Elliot Spitzer [of Mutual Fund inequitable pricing fame] v UBS.

In 1990's UBS moved brokerage customers to a new fee based wrap...InsightOne... which charged a percentage of account balance.

- ❖ The account promised a high level of service-which it did not deliver.
- ❖ UBS failed to supervise the behaviour of its advisers.
- ❖ UBS incentivised advisers to convert 'unsuitable accounts'.

Could something like this happen here in Australia?

### **A Personal Challenge to Every Financial Planner.**

The new financial year promises a very different world from the one we started so optimistically just 12 months ago. Your answers to these 7 questions will be a good indicator.

1. If your client's investment results are irredeemably negative are you critically reviewing your preferred researchers, fund managers and asset allocations?
2. I understand that the vast majority of industry education is sourced from fund managers. Last year I offered to do a presentation to a large dealer group. They gracefully replied that the presenters at their annual conference pay to speak. Are you accessing information from independent thinkers?
3. We must never over-estimate clients understanding of financial markets and financial risk. Many of those clients that happily nodded and said that they understood the risks as they were explained were probably just being polite. Have you a robust methodology to assess clients financial risk tolerance or are you still relying on 6 to 10 question 'portfolio pickers'?
4. How recently have you reviewed your value proposition? Is it predominantly about delivering better than market performance? Have you delivered that performance in the last 12 months?
5. Litigation lawyers are looking upon financial planners as easy targets. Have you a detailed methodology to show how you arrived at client asset allocations and manager selections?
6. Have you critically reviewed and do you understand the fundamental flaws in active managed funds? Have you a detailed defence or have you developed a view as to how you might migrate to a better alternative?
7. How will you fund your business when commissions are outlawed?

### **Concluding Remarks.**

For financial planning to be viewed as a profession, planners must be paid only for their advice; independently of product specific investment recommendations. There must be no suspicion of conflict of interest in a professional and fiduciary relationship.

I would want parents to say 'my son the financial planner' with the same pride as they say 'my son the doctor'

These days, it's not sufficient to argue that "planners provide excellent investment skills and financial strategies, so you should see one". That should be a given.

All the factors I have outlined have clear implications for the way planners present their services to prospective clients, who they target, the range of assets they give advice on, how portfolios are constructed & managed, how decisions are arrived at and the fees that planners charge.

For me, I want a fiduciary relationship with my financial planner. I'm sure I am not alone. I want a relationship where I can work collaboratively with my planner and where I can make a properly informed commitment on a regular basis. Fiduciary financial planning has much to offer the community. It would be criminal for it not to flourish.

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