

AUGUST - SEPTEMBER 2009

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Quality Advice

HOW TO DEFINE IT, AND HOW TO DELIVER IT

How to measure the value of advice

How can consumers be expected to value advice if planners themselves can't articulate what it's worth? Richard Weatherhead explains

The financial planning industry is constantly in the news, but for all the wrong reasons – Westpoint, Storm Financial and Great Southern spring to mind, even though these sad cases do not reflect the practices of the majority of professional planners. Often, commission-based remuneration structures are blamed for many of these poor outcomes for investors.

However, thankfully, there has been greater coverage over the past few weeks of the growing spirit of collaboration between various key industry stakeholders and government, with a growing sense that this will consolidate the sound professional foundations upon which the industry is built.

The Ripoll Inquiry into corporate collapses, financial services and products in Australia; the FPA consultation paper on Financial Planner Remuneration; and the IFSA Draft Super Charter are all key steps towards establishing that firm foundation. We must also not forget the much-anticipated review of “intra-fund advice”, which promises to open up new opportunities to deliver quality advice to superannuation fund members.

The quality of the advice has rightly been central to the overall debate around adviser remuneration, with many in the industry justifiably pointing out that levels of remuneration, whether in the form of commissions or fees, should be judged against the value of the advice provided. Does the customer get value for money from the advice they receive? Does the quality of advice vary between independent financial advisers, employed planners in banks or superannuation funds, telephone-based limited advice providers and aligned financial planners?

These are difficult questions to answer, as the quality of advice is itself generally a qualitative assessment. However, the task is not impossible, as we know that most people will not act unless guided through a plan. Consequently, one aspect of advice which can be measured is the financial

impact of implementing the recommended strategy for the customer, all else being equal. The financial impact is the improved position, less the cost of receiving the advice. While this is relatively easy to assess for investments or superannuation, it is more difficult for life insurance, where the benefit for those who do not die is intangible, being peace of mind and financial security for dependants.

SUPERANNUATION FUNDS

Feedback from superannuation funds suggests that the greatest demand for advice from their members, apart from advice related to the global financial crisis (GFC), is currently in the following areas:

- Whether and how much to contribute to super; and
- Moving or transitioning to retirement.

The value of advice to make additional superannuation contributions through salary sacrifice can be measured as a combination of the initial personal tax saving and ongoing reduced tax on investment earnings. Clearly this is a crude measure, as it does not assess aspects such as:

- Whether or not the recommended level of

contributions is adequate;

- The recommendation regarding the appropriate platform or superannuation fund; or
- The quality of advice regarding the investment option selection.

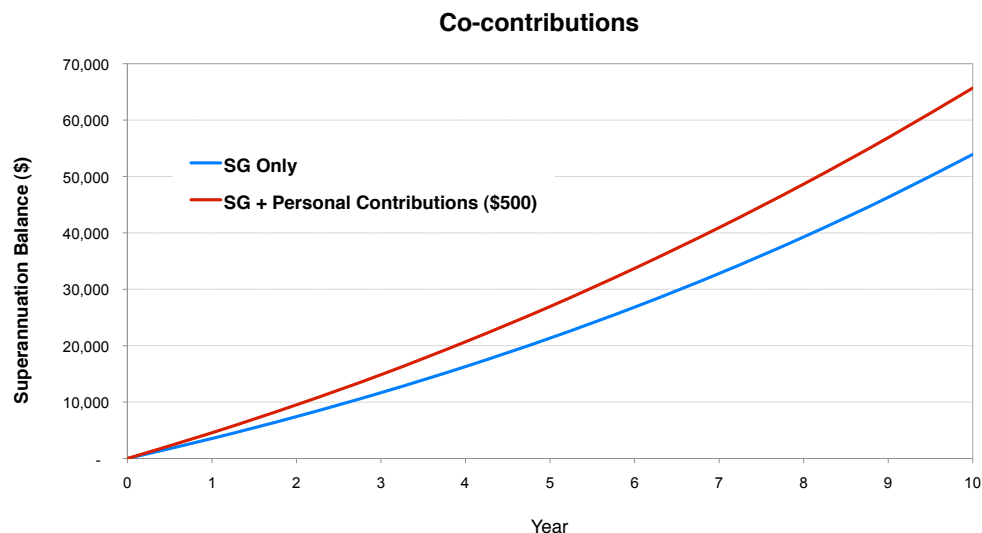
As such, it may understate the value, assuming that appropriate recommendations are made in these areas.

Two other examples of simple financial advice situations, where implementation of the strategy recommended by the adviser has measurable value for the client, are set out below.

CO-CONTRIBUTIONS STRATEGY

Despite the temporary reduction in the level of co-contributions by the Government, as announced in the 2009 Budget, a co-contributions strategy remains extremely valuable for mid to low income earners.

The blue line in the graph below shows the build-up of a member's superannuation account balance with and without a co-contributions strategy. The example considers a member earning \$45,000 per annum, whose employer makes Superannuation Guarantee (SG) contributions of



\$4050 per annum. Superannuation contributions are invested in a balanced option, earning 6 per cent per annum after superannuation tax and fees.

The red line shows the build-up of the account balance if additional non-concessional contributions of \$500 per annum are made into the same investment option, so that the member benefits from Government co-contributions of \$500 per annum.

The value of the advice in this case is the value of the co-contributions received; although it could be argued that the impact of the concessional superannuation tax rate on investment earnings as the co-contributions accumulate could also be taken into account.

The overall “value” of the co-contributions advice could also be measured as the additional superannuation balance after, say, 10 years – the difference between the blue and red lines in the graph. This is \$8240 after 10 years, and it could be discounted to be expressed in present day terms and compared against the commission or fee charged for the advice.

TRANSITION TO RETIREMENT

Despite the reduction in the cap on concessional contributions in the 2009 Budget, the transition-to-retirement strategy remains attractive for many people aged 55 and over.

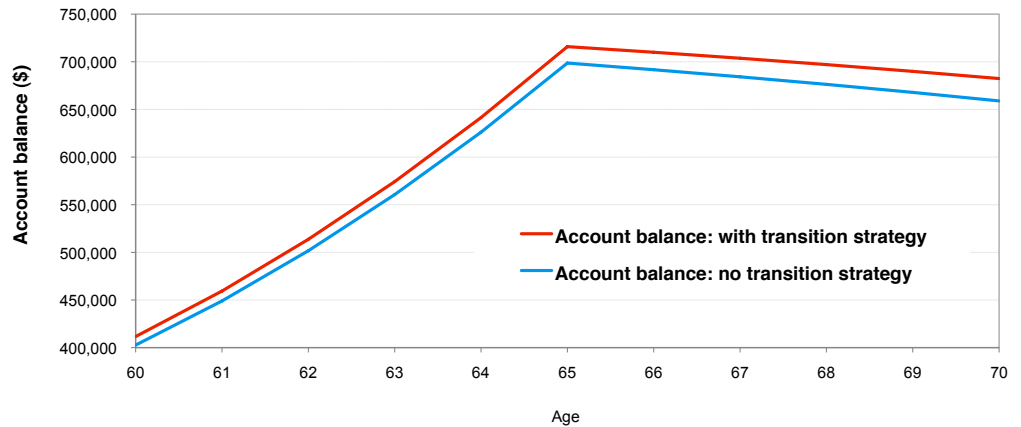
The graph below shows the build-up of a member’s superannuation fund with and without a transition-to-retirement strategy. In this example, the member is aged 55 at the start, earns \$80,000 per annum and has an initial superannuation account balance of \$250,000. They are advised to implement a transition-to-retirement strategy designed to maintain their post-tax income whilst optimising their transition-to-retirement pension and salary sacrifice amounts, to give the maximum ultimate retirement fund.

The accumulation account is assumed to earn 6 per cent per annum and the pension account 6.4 per cent per annum, after fees and taxes.

The client retires at age 65 and draws a pension of \$50,000 per annum thereafter.

In the graph, the blue line shows the build-up of the member’s account if they continue normal superannuation contributions up to age 65 and then draw a pension. The red line shows the corresponding build-up of the member’s overall

Projected account balance



account balance if they put in place the transition-to-retirement strategy.

Once again, the value of the advice to establish a transition-to-retirement strategy is reflected in the difference between the red and blue lines on the graph. In quantitative terms, this value could be determined crudely as the additional account balance, say, at age 70. On this basis, the value of the advice is \$23,476, which, once again, could be expressed in present-day terms and compared with the cost of the advice.

The examples above clearly involve relatively straightforward situations where the advice is non-controversial, with no account being taken of the complexities that usually arise as a result of each individual’s personal circumstances. In fact, this mathematical calculation of the value of advice probably understates its value, as advisers spend considerable time understanding all the personal circumstances of their clients and reflecting these in the advice provided. However, the approach does provide a framework for demonstrating the value of advice through hard outcomes-based analysis.

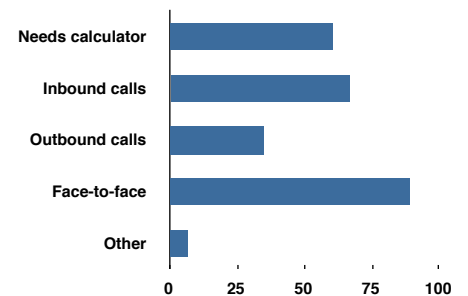
Access to financial advice has never been easier. There is a range of advice channels available to most Australians. The chart shows the various methods of receiving advice that are available to members of industry and public sector funds and employer master trusts.

In this chart “face to face” includes financial advisers and work site seminars and “out- bound calls” means proactively contacting members to offer advice.

Despite the widespread availability of a range of different delivery options, the take-up of financial

advice is still relatively low. There is a huge opportunity for advisers and funds which can implement pro-active, targeted contact strategies across superannuation fund membership bases.

How fund members receive advice



Given the value that professional financial advice can add for many customers and the saving that would be generated for the Government, for example, through lower ultimate Age Pension and related costs, there is a strong case for granting tax relief on the cost of financial advice - as proposed in many of the submissions to the Henry Tax Review and in the IFSA Draft Super Charter.

Nevertheless, the challenge for the financial planning industry is to gain public recognition for the value that professional financial advice can add - and simple, quantitative measures, such as those discussed above, are one tool that can be used to achieve this.

Broader distribution strategies for advisers and dealer groups are another thing altogether and could form a whole separate article. ■

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