# PERSPECTIVE

# WHY YOUR ADVISER

# ADVISER GOT IT SO WRONG

Photo-illustration Dorothy Woodgate

Perhaps you are wondering why you bothered with a financial planner? It's a good question.

**Story** Sally Patten and Leng Yeow

A history-making sharemarket crash is bad for everybody, but investors who sought out a financial planner would surely be better placed than someone who invested in any old balanced fund. Right?

Wrong. For many individuals a trip to a financial planner – seemingly a sensible approach to personal financial management – not only failed to protect them but in many instances delivered devastating losses.

Sean Abbott, principal of Aqua Private Wealth, is a financial adviser himself but is very critical of many of his peers.

"I don't believe that the majority of financial advisers have had sufficient education, training and experience in the complex field of portfolio construction," he says.

"Some of the disenchanted investors that I have seen would have been better served to have just picked a conventional funds manager and a balanced portfolio than take the advice of a financial planner. Many of my new clients have lost more money than the average fund as a result of a planner's poor advice."

Take 72-year-old Susan Blackburn (not her real name) from a beachside suburb of Perth. Between January and June 2007, her financial planner recommended she sell all her boring blue-chip shares and turbo-charge the returns on her portfolio with the likes of failed finance company Allco, media group News Corp and oil and gas explorer Arc Energy. Just 10 per cent of the portfolio was in cash.

When Blackburn discovered that by January 2008 the value of her nest egg had dwindled to $189,000 from $300,000 six months before, she demanded her planner sell the shares. But the adviser – who was being paid a percentage of assets under management – convinced her not to. By June last year, her share portfolio had sunk by another $60,000.

Not all the advice being dished out by Australia's 18,100 financial planners has been as inappropriate as recommending a retiree put 90 per cent of their portfolio in shares – and some high-risk ones at that.

A recent survey by research company brandmanagement found that individuals who use a planner rated them as highly trustworthy and value for money. However, the research was commissioned by the Financial Planning Association of Australia, and Blackburn's story is far from unusual.

There are a lot of angry investors who never expected to suffer such huge losses and who do not understand that, as most financial planners operate on a commission basis, they have an incentive to tip them into high-risk products which typically pay higher commissions than more defensive investments like cash.

The most disenchanted investors would probably be those who took advice to borrow to invest and now find they are paying their adviser a percentage of the debt they have yet to pay off.

Still, they have one consolation: financial planners are hurting too.

"The industry has never been in more pain," says Strategic Consulting and Training managing director Jim Stackpool. "These are unprecedented times for financial planning groups. Their revenues have been hit hard."

Sam Henderson, chief executive of advice firm Henderson Maxwell Investments & Retirement Solutions, agrees. "Advisers are in a lot of pain. Funds under management have fallen 30 per cent from their highs. Their profits are gone. They are working to eat at the moment."

To make matters worse, they can expect to be hit with a suite of legal actions, which may be hard to defend given a recent legal precedent, says Peter Bobbin, principal of Argyle Lawyers.

Jobs are being lost across the industry. Just this week Australia and New Zealand Banking Group said it would reduce its planner force by 10 per cent.

Last month, boutique dealer group Centric Wealth made six staff redundant and asked its remaining staff to take a voluntary 10 per cent salary cut, after its part-acquisition by private equity firm CHAMP Private Equity.

More than 370 employees were told to either take a pay cut or opt to work four days a week. Centric Wealth will not be paying staff discretionary bonuses this year.

It is understood that AXA-owned dealer group Genesys Wealth Advisers is planning to scale back its commitment to proprietary managed funds research this year. Last month, Genesys' four-man research team defected to rival RetireInvest, but rather than replace the team in-house, Genesys management is considering outsourcing research to an external ratings house.

Rumours are rife that some planning firms are about to hit the wall. Some planners have even decided not to bill some of their very upset clients in order to protect their business.

On top of the turmoil delivered by the credit crunch, the sector now has an equally serious problem: its credibility. As investors try to work out what went wrong, the financial planners can expect to come under close scrutiny from governments, regulators and the courts.

The central problem is that the majority of them are not just paid by their clients – they get commissions from the makers of financial products, thus there is a conflict of interest. Second, the way they charge brings them huge

# BEWARE THE DIY TRAP

People are increasingly turning to self-managed super and are certainly being encouraged to do so, particularly by those who can make money advising on a do-it-yourself option.

Known as DIY super, this option appeals to investors who have been burnt by advice from planners and wish to assert more control over their financial destiny. The trouble is there are traps for the unwary. It is not clear that jumping from the arms of one financial planner to another who apparently offers more control will be a great leap forward.

What a DIY fund offers is more investment scope. It can hold individual buildings and shares as well as all sorts of exotic assets that a conventional super fund would not permit. However, the adviser who recommends the fund be set up often provides advice to invest the capital.

Daniel Brammall, of Australian Independent Financial Advisers, says it is important to distinguish between objective advice and a sales pitch masquerading as advice. The DIY adviser may have the same suite of practices, such as commissions, trails and percentage-based payments, that other planners use and you could find you are paying a very heavy price for planning advice.

"The 'fee' being charged by most planners these days is a percentage of funds under management, which is a commission by another name," says Brammall.

He points to a dubious practice in which some planners advise their clients to sweep some of their other assets into the fund – assets the planner had no role at all in building up. For example, a doctor may be advised to put his surgery or other buildings into the self-managed fund.

So far, so good. There may be benefits. And if the planner just takes a dollar fee for this advice, all may be well.

However, what the client may not understand until it is too late is that the planner has just increased his or her income significantly because the adviser takes a percentage of the size of a now very expanded fund.

"The adviser then is horribly conflicted," says Brammall.

**Staff reporter**

Daniel Brammall says it is important to distinguish between sales pitches and genuine advice. Photo Glen McCurtayne

and arguably unearned, fees. Rather than just charging a set dollar amount for the work done, they get an ongoing annual payment based on a percentage of the value of the asset under management. Few investors have a clue about how much this can cost them over time.

Still, the value of those assets has now collapsed – and so too have advisers' revenues. As Alex

"People know commissions are a dirty word, but they don't understand why," he says.

One of the biggest threats to the planning industry is that many outraged clients will leave the sector altogether and set up self-managed super funds, which tend to use traditional planners less.

Dixon Advisory, which specialises in administering self-managed retirement vehicles, says

Services Ombudsman reports a 114 per cent surge in complaints against planners in the six months to December 2008, compared with the same period in 2007.

The scale of the increase is only exceeded by the 168 per cent rise in complaints against fund managers.

Ombudsman Alison Maynard says the main reasons for the disputes are inappropriate advice, poor service standards,

have a different designation. This is more a sales role than an advising one."

Then there is the legal action.

Slater and Gordon is acting on behalf of 700 former Storm clients to recover around $100 million, and the Australian Securities and Investments Commission is still pursuing suits against PIS, Bongiorno, Masu Financial Management, Strategic Joint Partners and State Trustees, for

Financial Pursuit sold out to Perpetual in March.

Charles Smith, ING general manager of aligned distribution, says: "There's no doubt that businesses are hurting. Incomes are down, compliance costs are up, and the risks associated with running your own licensee are great. The aftermath of Storm Financial is impacting consumer confidence and the impact of the global financial crisis is taking its

the value of the asset under management. Few investors have a clue about how much this can cost them over time.

Still, the value of those assets has now collapsed – and so too have advisers' revenues. As Alex Dunnin, director of editorial and research at research firm Rainmaker, points out: "If you get paid asset-based fees, your revenues will have fallen. You have either got to get new business or lower your costs."

Meanwhile, unhappy clients are voting with their feet.

There is "no question" angry clients will up sticks and leave their advisers, says Daniel Brammell, of Australian Independent Financial Advisers.

"There will definitely be a migration from tainted advisers to genuinely independent advisers."

AIFA, which operates a pure fee-for-service model under which the size of fees is completely divorced from the level of a client's assets, says it has experienced a slight rise in inquiries recently from savers looking to shift planners.

Bennelong Private Wealth, operating a fee-for-service model, says since late February there has been a dramatic rise in inquiries from investors disenchanted with their existing planners.

"In my practice there was a slowdown in new client queries from around October 2008 to mid-February 2009," says Bennelong managing director Bill Raffle. "I think that many people were panicked and frozen in the headlights of indecision.

"From mid-February and into March, there has been a significant increase in inquiries and it seems that some people have recovered from the initial shock and would like to determine what action to take from here."

That said, some experts believe the demand by savers for planners who charge a dollar fee for service rather than receive commissions will rise only slowly.

Brammell argues this is because most savers still don't understand how much they are paying in fees and the potential conflicts of interest.

outraged clients will leave the sector altogether and set up self-managed super funds, which tend to use traditional planners less.

Dixon Advisory, which specialises in administering self-managed retirement vehicles, says the level of interest from savers wanting to take full control of their super accounts is significant. He compares the 2008-09 financial year with 2006-07 when individuals injected billions of dollars into super ahead of sweeping changes to the tax rules introduced in July 2007.

Between July last year and February 2009, Dixon Advisory opened 352 self-managed funds on behalf of clients, up from 238 for the corresponding previous period and not far off the 375 do-it-yourself accounts it established in 2006-07, when the firm was forced to turn customers away.

"It [setting up self-managed funds] is a typical reaction by people who have lost a lot of money and want more control over their investments," says Dixon Advisory managing director Alan Dixon.

"Everyone has lost money and people are starting to pull apart their statements to see how much they are paying in fees. The concept of taking control is very attractive during downturns."

But DIY funds are not necessarily free from commissions or trails and Dixon Advisory itself reveals in its financial services statement guide that it "may receive ongoing payments, called trailing commissions, from financial product issuers".

According to the Australian Tax Office, between September last year and January 2009, the number of DIY funds applying to register surged 20 per cent, although the rate fell back in February.

The self-managed funds sector is growing and accounts for almost 31 per cent of total assets. Yet the sector is not free from the more controversial practices common to the wider planning industry. (See box above.) Meanwhile, planners are being hit with more official complaints and law suits over inappropriate advice. The Financial

The scale of the increase is only exceeded by the 168 per cent rise in complaints against fund managers.

Ombudsman Alison Maynard says the main reasons for the disputes are inappropriate advice, poor service standards, misrepresentation and delays to requests for fund redemptions.

David Andrew, chief executive of Capital Partners Financial Consulting in Perth, believes the regulator should step in.

He points out that industry research has confirmed that the majority of financial planners are actually commission-based.

"I think if financial advisers can clearly demonstrate that they are dollar-fee based and delivering a clear service to their clients via an agreement, then the Australian Securities and Investments Commission should license them accordingly. Alternatively, where an adviser is commission-based – that is, being paid by the product manufacturer – then ASIC would

**There is a fair bet Rudd and Sherry will push for changes on the way commissions are paid on the super guarantee. That will be a game changer.**
Jim Stackpool, Strategic Consulting and Training

behalf of 700 former Storm clients to recover around $100 million, and the Australian Securities and Investments Commission is still pursuing suits against PIS, Bongiorno, Masu Financial Management, Strategic Joint Partners and State Trustees, for $63.2 million.

Consumers had a small win last year when the District Court of Queensland found financial planner Paul Brannelly liable for negligence in relation to Westpoint and ordered him to pay $860,000 in compensation.

These are just the headline cases. Behind the scenes, hundreds of consumers lodge complaints and seek damages for negligence each year.

"It's only going to get worse," says Argyle's Peter Bobbin.

According to Bobbin, an increasing number of financial planners are encouraging their new clients to seek legal advice and potential compensation for inappropriate advice by their past planners.

"We're busier than ever, largely because of an upsurge in planners referring their clients to us and asking us to assess their old financial plan, and determine if their previous financial adviser was negligent," he says.

"Financial planners have no hesitation in urging clients who have suffered due to the poor advice of another planner to seek redress."

As a result of the turmoil hitting planners, many expect the industry to consolidate.

This past week, two superannuation funds, SAS Trustee Corporation and Australian Reward Investment Alliance, announced they were seeking to sell jointly owned financial planning business State Super Financial Services for about $280 million.

In January, medium-sized dealer IFA Securities closed and most of its planners joined ING's Millennium 3 dealer group. ING also acquired a 37.5 per cent stake in West Australian dealer Sentry Financial Group in January. Meanwhile, Sydney-based

businesses are hurting. Incomes are down, compliance costs are up, and the risks associated with running your own licensee are great. The aftermath of Storm Financial is impacting consumer confidence and the impact of the global financial crisis is taking its toll on planners."

Not that it is a great time to sell. According to John Nesbitt, head of Perpetual Private Wealth, the price of planning businesses has fallen significantly in the last two years, and are trading on EBIT multiples of 5 to 7 times, down from the multiples of 8 to 12 times being asked for in November 2007.

"Financial planning revenues have been falling since late 2007, and principals need to be more realistic about what their businesses are worth," says Nesbitt.

Michael Pillemer, chief executive of Centric Wealth, says the price changed substantially as markets changed.

"The original plan was for CHAMP Private Equity to underwrite a rights issue but that was all happening in the middle of the collapse of Lehman Brothers in September 2008, and they pulled out of that deal," Pillemer says.

David Jones, managing director of CHAMP, adds: "The deal went through a series of iterations because the world was going through turmoil in the second half of 2008."

As if the sharemarket collapse isn't bad enough, Corporate Law and Superannuation Minister Nick Sherry is hovering in the background with his review into how best to lower fees paid by consumers on their super savings.

Sherry would like fees on super guarantee contributions to fall below 1 per cent of funds under management, considerably below the current average of 1.2 per cent.

"There is a fair bet [Prime Minister Kevin] Rudd and [Senator] Sherry will push for changes on the way commissions are paid on the super guarantee," says Strategic's Stackpool.

"That will be a game changer."

▶ John Wasiliev, page 40

FRA 023