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Advice reforms versus reality

industry bogie, explains Leggett, is ASIC's inability to prevent dodgy financial planners, sacked for providing dishonest advice, from resurfacing elsewhere.

Without any legal compunction within a code of advice, he says the onus is on the licensee, which is subject to the Corporations Act, and not the adviser.

While FoFA reforms did enhance ASIC's licensing and banning powers, another glaring loophole is its inability to award compensation. Although ASIC provides a financial advisers register – which launched on its MoneySmart website on March 31 – it doesn't check or review the information provided.

Assuming proposals within a Parliamentary Joint Committee Report on Ethics and Professional Standards are finally approved later this year, existing advisers will have until 2019 to transition to proposed new standards, which include ongoing training, a registration exam, compulsory professional body membership, a code of conduct and continued professional development (CPD).

De Gori believes most advice firms have already commenced the transition and are implementing increased training and qualification requirements for their existing advisers, plus the need for professional body membership. In the past year, training provider Mentor Education has witnessed a 93 per cent increase in the uptake of ethics courses students undertake within its CPD program.

"With FPA membership representing 40 per cent of all financial advisers, and less than 10 per cent of ASIC enforcement action, there's no better evidence that codes of conduct are raising adviser standards," De Gori says.

While he concedes compulsory membership would be a step in the right direction, Leggett says there's only so much legislation or industry codes can do to eradicate dishonesty. "The problem with outfits like Storm Financial wasn't the projects per se, but the amount of remuneration on offer that led to unethical practices, and no amount of legislation or codes can prevent this," he says.

Leggett's concerned that "over compliance" is sometimes at odds with encouraging Australians to embrace financial advice. He says good advisers can find themselves on the wrong side of compliance on technicalities, and usually around paperwork.

"Sometimes added FoFA compliances, like the need to provide a financial services guide, are less about consumer protection and more about 'butt covering'," Leggett says. "Clients aren't interested in an adviser's compliance regime, and sometimes acting in their best interest means running the risk of being non-compliant."

Given that it's possible to act dishonestly while still ticking all the compliances boxes, Elixir Consulting principal Sue Viskovic agrees paperwork can be a waste of a client's time. Nevertheless, she's witnessing a significant commitment by the advice firms to implement higher standards and deliver better client outcomes.

Unlike five years ago, when anyone with minimum qualifications was hired, she says greater scrutiny around screening and hiring, and greater checks and balances around employment contracts, are becoming the new industry norm.

These days, she says most advice firms also want to see an adviser's compliance scores before hiring.

"Something as innocuous as a hard copy file failing to have a date of birth can result in a lower score, so it's easy to fall foul of regulations," says Viskovic.

"It's important for compliance officers who do these audits to look beyond why someone may have tripped over advice documentation, and place greater emphasis on the quality of the underlying advice."

Sequence risk not the ogre of the aged

Paul Resnik and Peter Worcester

Discussions of sequence or series risk regularly appear in the financial media and are increasingly appearing in the general press. In simple terms, fear of sequence risk drives investors to take equity and growth asset exposures out of their retirement portfolios.

More specifically, sequence risk is the fear that a series of bad returns in the early stages of retirement drawdown will significantly diminish capital values to the extent that the portfolio is incapable of recovery, can't support future drawdowns and will not meet its investor's longer-term needs.

However, analysis of Australian historical data suggests that sequence risk for retirees may not be the danger claimed. If this is true, then many of the standard approaches to investment within retirement plans are flawed. Specifically, this includes many notions of decreasing growth asset exposure with age.

History actually shows there are good arguments for increasing growth-asset exposure around retirement. This is consistent with the data from South Africa, the United Kingdom and the United States.

The common view is that retirees need a lower exposure to growth assets in retirement than in their accumulation period. On face value, this would seem to be sensible. While the returns are lower, so too should be volatility.

As an example, for a $100,000 portfolio with 40 per cent allocation to growth assets (based on accumulation indexes commencing in 1972 rebalanced once a year) we draw down $3000 a year, $5000 a year and $7000 a year, adjusted for inflation. There is no allowance for fees, taxes or other frictions which can amount to 2 per cent or more each year. The real balances after 10 years are shown in the first table.

"Best" and the "worst" balances are extreme outcomes. The "good" result was higher than 95 per cent of outcomes and, similarly, "poor" is a result higher than only 5 per cent of outcomes.

The account balances alone don't provide any easy insight into the future, so we looked to reinterpret the data consistent with the number future years the real income might continue to be withdrawn at the end of the tenth year.

We can divide the closing real balances for future annual payments by $3000, $5000 and $7000 and see the future year payments.

After 10 years an investor withdrawing $3000 a year had on average 47.3 more years' payments. In the poor case she had 22.4 more years. And in the very worst 15.7 more years. After 10 years our investor withdrawing $7000 a year had on average 12.3 more years' payments. In the poor case she had 2.8 more years. And in the very worst 0.8 more years.

How does this compare with the client who took on the additional 40 per cent equity risky asset exposure and ran with an 80 per cent growth-asset portfolio?

Best, good and average returns are generally consistent with what most would expect.

The additional growth asset exposure delivers better returns.

The poor and worst returns are another matter. They are counter-intuitive. Investors didn't necessarily have a lower return for lower growth asset exposure.

Investors were not significantly worse off for taking the 40 per cent higher exposure to growth assets.

What's driving the result? Simply, it's reversion. After every drop in each portfolio there's a recovery. The portfolio with the higher growth asset exposure participates more fully in recoveries. There was no financial reason to reduce growth asset exposures.

Investors must be able to emotionally cope with the short-term vagaries of portfolio and asset values and stay appropriately invested.

As ever, while the past is often a useful precursor of the future, it's never the same as the future.

Paul Resnik is co-founder of risk tolerance consultancy FinaMetrica. Peter Worcester is a Consulting Actuary.

No pain, no gains

Real end value of $100,000 after 10 years

Withdrawal rate	3%	5%	7%
Best	$227,696	$195,809	$163,922
Good	$207,996	$175,609	$143,652
Average	$141,818	$114,098	$83,378
Poor	$67,300	$42,524	$17,747
Worst	$47,030	$26,972	$5,867

Real end value as a multiple of the real annual drawdown

40% GROWTH PORTFOLIO

Withdrawal rate	3%	5%	7%
Best	75.9	39.2	23.4
Good	69.3	35.1	20.5
Average	47.3	22.8	12.3
Poor	22.4	8.5	2.8
Worst	15.7	5.4	0.8

80% GROWTH PORTFOLIO

Withdrawal rate	3%	5%	7%
Best	111.4	56.3	32.6
Good	81.1	41.9	25.1
Average	54.3	26.7	14.8
Poor	26.2	10.5	3.4
Worst	16.1	5.4	0.6

SOURCE: FINA METRICA

The demise of specialisation in financial services

Comment

David Heather

It wasn't that long ago that financial services were all about specialisation.

Stockbrokers looked after people's equities portfolio, investment managers provided managed funds, insurance agents sold insurance, accountants provided accounting services, financial planners provided strategic advice, mortgage brokers found the cheapest loans and specialist administrators performed administration services.

Everyone had clearly-defined roles and clients used several providers to get their total wealth needs met.

Businesses and reputations were built on specialisation.

Over time, some businesses started to combine two or three components. For example, risk insurance and financial planning; accounting and super fund administration; and stockbroking and investment management.

That trend has been steadily accelerating due to regulation, greater competition, changing consumer needs and growing technological disruption in financial services.

The rise of the non-institutionally aligned, integrated one-stop shop model, which either internally or externally provides and oversees the management of a client's total financial needs, is the next major development in wealth.

A growing number of savvy advisory firms already offer everything from mortgage broking to investment advice and estate planning. They're catering to the demands of time-poor clients who want the convenience of one trusted partner managing their entire financial affairs.

Technology is a key driver of this trend. It's making it easier for commercially-minded non-institutional participants to effectively compete.

At the same time, the large vertically-integrated institutions are under pressure to unbundle product and financial advice because of their inability to properly manage conflicts of interest.

The vertically-integrated model, where a company – commonly a large institution – owns each part of the value chain from manufacturing (typically investment product) to administration (platform) and distribution (financial advice) is often criticised because of the potential conflicts that exist when a product manufacturer also controls financial advice.

This model has been extremely effective at yielding mega profits for shareholders but dismal at delivering optimal client outcomes because it's built around the product not the client.

The product – be that insurance, super or an administration platform – comes first. Banks and institutions are only in advice to distribute that product.

However, the natural outcome of this flawed approach has consistently been mis-selling, leading to enormous reputation damage for the institutions embroiled and multi-million dollar compensation bills.

Institutions are now looking to separate wealth from their core business activities.

Locally, Westpac has moved to sell part of its shareholding in BT Investment Management while it's understood that two of the remaining three big banks are trying to divest parts of their wealth arms.

But it doesn't have to be this way.

A new generation of market participants are rising up and offering a vertically-integrated solution, only this time the client is firmly at the centre of the process.

Advisers understand their clients' current tax and financial situation, ongoing needs, and long-term goals and objectives. They're ideally placed to offer, or facilitate, multiple services. More importantly, they have the right skills and motivation to do it.

In the past, financial planners automatically recommended external fund managers and/or referred clients who wanted to buy and sell shares to a stockbroker.

Today, they're increasingly able to provide advice on direct shares and a range of other assets leveraging the same research used by many institutional fund managers or better still, implement solutions that enable them to manage portfolios on the client's behalf.

It helps that traditional fund managers haven't performed in line with client expectations despite charging hefty fees. As a result, consumers have developed a myopic focus on fees and a willingness to try new ways of assessing investment skill to achieve a better and more cost-effective outcome.

This has been a boon for new players offering exchange-traded funds, listed investment companies, managed accounts and other more flexible, efficient and transparent solutions.

With technology, advisers can build, manage and administer their own bespoke investment solutions across any asset to complement the traditional financial planning services they provide.

They can do this by partnering with an investment manager or they can keep everything inhouse. It's not that much of a stretch any more.

That has grave consequences for traditional fund managers, platforms and stockbrokers.

The recent foray of stockbrokers like SHAW Partners into financial planning is nothing new. Stockbrokers have been dabbling in investment advice for decades. What's new is how stockbrokers are now broadening their wealth repertoire.

This will continue as the lines between what a financial planner does, what a broker does, and what every other industry participant does blurs further. Accountants are a prime example. Under the new licensing regime, they must be licensed in some form from July 2016 to provide basic advice on their bread and butter, self-managed super funds.

Similarly, financial planners need to meet additional licensing conditions to provide tax advice.

What's the future of financial services? There will always be specialist business models but with the blurring of the lines, there will be increasing choice available to consumers who prefer a one-stop-shop approach.

Any market participant who can develop a scalable, integrated offer by bundling services together using technology as an enabler should be able to deliver a whole solution at a lower cost.

With good quality solutions that are cost effective and deliver improved client outcomes, maybe financial services aren't out of reach to the average Australian after all.

David Heather is chief executive officer of specialist managed account provider, managedaccounts.com.au.