CPD: A strong duty of care for seniors will increase the value of your business

26 Feb 2021

From **Domacom**

There has never been a greater need for sound financial advice, especially Australians in or nearing retirement.

Strange as it might seem, financial advisers might be on the cusp of a golden era. Not only will it enhance their bottom lines, but it will increase the market valuations of their practices. For those that focus on senior Australians, the financial rewards could be even more pronounced.

There are myriad reasons for asserting this proposition, but three stand out: (i) retiring baby boomers, who number more than 20 per cent of the population, will be retiring in droves in the years ahead, (ii) the fact many do not have financial advice, and, (iii) for some, the family home will be their biggest asset and will need to be an integral part of their retirement income strategy.

These are not the only factors at play, of course. The banks exiting wealth management in the wake of the Financial Services Royal Commission has been well documented (this trend was evident before the inquiry), the decline in the number of advisers in response to rising educational and professional standards, and the industry shift from commission-based remuneration to fees. For many advisers, the speed of change was too much.

For those advisers who have adjusted to the new environment and are aligning themselves with the higher ethical and educational standards, opportunities abound. But it is imperative they get on the ethical and professional bandwagon. Courtesy of the Royal Commission and parliamentary inquiries, there has been no shortage of evidence casting the advice industry in a bad light. And, sadly, it has a long history.

Remember, for example, the Timbercorp Group, which offered investors managed investment schemes in olives, almonds, and timber, that went into voluntary administration in April 2009. Two months later, the liquidators were summoned – the day of reckoning for nearly 20,000 investors was nigh.

Over its 17-year history, Timbercorp had raised more than $2 billion from these investors, many of whom not only lost their investment, but, in some instances, were bankrupted because they had borrowed from Timbercorp's finance arm (backed by ANZ) to invest in these schemes. With the company in liquidation, their investment had gone sour, yet they still had debts owing, making bankruptcy their only option.

The bitter aftermath of Timbercorp's demise became a veritable lawyers' picnic. It went on for years. In all of this the role of financial advisers, and how they how exercised their duty of care to these investors, became a critical issue.

In the event, ASIC's investigation into Timbercorp's collapse concluded there was no systemic mis-selling of these agribusiness schemes by financial advisers that warranted enforcement action. But several advisers were required to write to clients where the advice was "potentially inappropriate" to explain to them how they could make a complaint.

That was ASIC's letter-of-the-law ruling. But did it pass the pub test? Did these advisers meet their duty of care to their clients? Clearly there were several red flags. First and foremost, these schemes were tax-driven, and, as history tells us, such schemes are typically unviable.

A promised after-tax compound return of 14% highlighted that old investment maxim – if a return sounds too good to be true, then it probably is. Many investors, and some advisers, simply did not understand the risks involved with this investment product. Again, a golden rule – if you don't understand it, you shouldn't be in it, and you certainly shouldn't give advice about it.

This is the image – and type of financial product – that the advice industry is leaving behind. They understand that ethical, professional advice that creates more trust and confidence will command a premium in a growing market, especially from retiring baby boomers.

To ensure this happens, the advice industry must commit to the principle of "duty of care". If it does so, much of what's required to have sound ethical standards and professional behaviour will fall into place. Although "duty of care" has become one of the industry's buzz words that gets thrown about like confetti, it is the primary principle underpinning the industry. So, what does it mean?

Under the ASIC Act and the Corporations Act, financial advisers must:

- Not engage in unconscionable conduct or misleading and deceptive conduct
- Act in the best interest of the client
- Not make false or misleading statements
- Provide their services with "due care and skill" (a term to this effect is implied into all contracts between financial advisers and their clients)
- Provide their services efficiently, fairly and honestly
- Provide advice that is appropriate for the client, taking into account the client's needs, objectives and circumstances; and
- Provide clients with a variety of documents such as financial services guides and statements of advice.

As these legislative frameworks highlight, a duty of care is one of the basic tenets of financial advice. Aside from these two Acts mentioned above, it is also embedded in the Financial Adviser Standards and Ethics Authority's (FASEA) Code of Ethics. FASEA was established in April 2017 to set the education, training, and ethical standards for financial advisers.

In essence, what it is saying is that advisers must always act in the best interests of their clients and to place the client's interests above their own when giving advice. By doing so the adviser engenders trust into the relationship, with the client having confidence that the adviser is always working in his/her best interests. This doesn't mean the advice is always perfect; but it does mean it is ethically based.

So, what does this require of the adviser? To always act in accordance with the appropriate professional conduct and ethical standards laid down by the relevant professional body. It means disclosing all relevant facts to the client at all times. This includes any compensation arrangements and potential conflicts of interest, not only between the client and adviser but the adviser's employer and/or AFSL.

Transparency is critical to the client-adviser relationship. Regular communication affords both parties a better understanding of the relationship, as well as providing a safety net in the event of potential conflicts of interest or a change in the adviser's approach to business and/or investment.

It's also imperative that clients fully understand the nature of the services they are getting from an adviser, and what will be the compensation for those services. The latter point is critical when it comes to any non-salary compensation an adviser receives.

At a practical level, there are several steps advisers must take to ensure duty of care. First, they need to conduct a "fact find" to establish, as well as possible, the client's objectives and goals. Issues that will be important are a client's health (as well as their partner's health), what are their likely income needs (how many dependents and lifestyle expectations), CPI, likely living costs (are they renting, or do they own their home), risk assessment, and do they wish to downsize.

Then there are the four pillars of retirement income to be considered: superannuation; existing savings and investments; home ownership; and eligibility to the aged pension and social security.

With growing doubts about whether the Superannuation Guarantee (SG) will be increased, as well as calls for superannuation to be open to first home buyers, for example, the dynamic between these four pillars is likely to change. Advisers need to be aware of these broader changes to the system to be meeting their duty of care.

Financial modelling also comes into play to find those investment strategies and products that will best meet the client's need for income and/or capital growth. This could mean a diversified portfolio, buying an annuity, or an equity release product. No one size fits all, and duty of care means finding the right fit for each client.

Remember, too, there are specific requirements relating to financial modelling. Under RG175, advisers are obligated to maintain their industry knowledge about new products, investment options and alternative strategies. Under Standard 5 of the FASEA Code of Ethics, advisers cannot allow their APL to limit their view of potentially suitable products; putting round pegs in square holes will not satisfy their duty of care.

Advisers must also be conscious of the fact that more consumer protections have been built into the legislative and regulatory regimes governing the industry and this is further leveraging consumer confidence. But these protections come at a financial cost to the consumer. So, there is an urgent need to make professional financial advice more affordable and accessible, and to achieve this the red tape around the delivery of financial advice needs to be cut – without lowering either ethical or professional standards.

In particular, advisers must have greater flexibility to offer single-issue advice or scaled advice, especially as it relates to retirement income strategies. The cost of not doing so could lay the groundwork for a far bigger social injustice as people make life-changing financial decisions without any advice.

If the Government does take this step – and there are indications, especially in the wake of COVID-19, that they will do so with ASIC currently reviewing submissions to its Consultative Paper 332: *Promoting Access to Affordable Advice for Consumers* as part of this process – then it will potentially create a fresh client base for advisers, particularly among those nearing or in retirement. For those doubting the need for greater access to advice, especially by baby boomers, consider the following:

- An estimated $3.5 trillion will transfer across over the next 20 years, an enormous intergenerational wealth transfer;
- 76% of Australians have no will, of whom many will be baby boomers;
- 53% have not discussed their legacy with their children;
- 70% of families lose their wealth by the second generation;
- 90% of families lose their wealth by the third generation;
- Australians over age 71 have $30 billion in home loan debt;
- Many baby boomers missed the superannuation boat with the SG only being introduced in 1992;
- Current low interest rates are likely to remain so for many years;
- Lower dividend payments because of the COVID-induced recession; and
- The need for professional advice has never been so great.

For all these reasons, there will be a thirst for advice, and nowhere will this be more evident than with the baby boomers' family home. Options for those nearing or in retirement are to sell to either downsize or opt for a sea-change. But research shows that for many people at this stage of life neither option is particularly palatable. Surveys by seniors' organisations like National Seniors Australia have shown they would much prefer to age "in place", meaning a form of equity release – and for this, many will need advice.

For advisers, this will become an integral part of the new frontier as it has the potential to generate different business streams, as Steve Prendeville, Founder and Managing Director of Forte Asset Solutions, a specialist in financial services mergers and acquisitions, explained to a recent webinar on the Downsizer Legislation.

Establishing relations with baby boomers opens the door to extending the business relationship to children, grandchildren, even extended families. As any marketing person knows, a recommendation from personal experience, especially when it comes to professional services, has enormous validity. It also means the baby boomer becomes an active, not passive client, and with that activity comes the opportunity to enhance revenue streams.

As Prendeville highlighted, this is not a one-way street. These baby boomers will benefit from getting advice, many for the first time. It takes the adviser-client relationship beyond the traditional areas of retirement advice, social security information, and monitoring to intergenerational advice, estate planning, equity release and aged care. In short, it transforms the advice package – and the practice.

Prendeville used the example of a suburban practice to make the point. With 157 clients, it had annual receivables of slightly over $600,000, FUM of $112 million and EBIT (earnings before interest and tax) of $180,000. Clients were sticky, earnings and revenue consistent, there was no over reliance on key clients, and the average FUM was $715,000.

But there were weaknesses. The demographics showed an ageing client (56% were 70 plus) representing mortality risk, little growth, asset-based fees, no service segmentation and key man risk. Based on these numbers, the practice could be priced at either two times revenue at $1.2 million or 4.8 times EBIT at $864,000. But if generational advice is added to the mix, then revenue is priced at 2.2 times for $1.350 million or EBIT at 5.4 times for $1.08 million – sizeable differences.

When the family is brought together to make lifetime decisions and the children witness the care and consideration for their parents you can offset mortality risk by retaining FUM with the second generation.

Obviously, the addition of intergenerational advice depends on how many are receiving that advice, but as a rule of thumb the involvement of clients' children can add 20% of the value of the business, as well as lower the average age of the client base. It's worth remembering the Pareto Principle – for most businesses, 20% of clients generate 80% of revenue.

The financial advice industry has endured several tough years. Yet there has never been a greater need for sound financial advice, especially Australians in or nearing retirement, providing enormous opportunities for those advisers who are prepared to meet the challenge.

Take the quiz to earn 0.25 CPD hour:

PLEASE SIGN IN TO DO THIS QUIZ

0 comments | Tweet | Recommend 0 | Share | print | email

Tags: Steve Prendeville

You must be logged in to post or view comments.

ALSO ON ADVISERVOICE

AFA CEO Philip Kewin steps down

Infrastructure investment is core to the climate solution

BT Panorama welcomes more than 38,000 BT Wrap customer accounts; FUA reaches $49 billion

Evergreen launches Responsible Investing Grade Index

Sweat the small stuff: it is what we CAN control!

Russell Hannah confirmed as General Manager, Distribution and Marketing at Integrity Life

Roar Software patents Highlighter

EARN CPD POINTS

CPD: Ethical obligations in a financial advice practice
On 1 January 2020, FASEA's code of ethics became enforceable by law, requiring advisers to comply with its 12 detailed [...]

CPD: Chaos theory - how APRA's Disability Income Proposals and the Best Interests Duty are connected
Introduction "Does the flap of a butterfly's wings in Brazil set off a tornado in Texas?" This was the question [...]

CPD: The hunt for yield can lead to risky territories
With interest rates hovering around historical lows globally, investor appetite for alternative income sources has markedly increased. In the current [...]

CPD: 5 big questions the RBA needs to answer in 2020
After extremely strong fixed income returns in 2019, the interest rate outlook for 2020 is far more sanguine as the [...]

CPD: The changing nature of work in Australia, implications for advisers and the broader protection ecosystem
Introduction As professional service providers, it is vital (and legally required!) for financial advisers to understand each of their clients [...]

View more CPD