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Shopping for Financial Planners: Uncovering the Grey Areas

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A rush of people expected to leave the workforce over the next few years has prompted the corporate regulator to take a fresh look at the financial advice they are receiving. The focus of the latest review by the Australian Securities and Investments Commission (ASIC) will be on the quality of advice that planners give to retirees.

ASIC is dispatching shadow shoppers to glean what sort of guidance and information planners are offering, but – as with similar exercises in the past – says there will not be any "naming and shaming". Instead it's a chance to better understand whether the advice planners are doling out is appropriate to an individual retiree's circumstances.

"The beginning of the baby boomers are starting to retire and the de-accumulation phase of superannuation is going to double from 20% in the next few years," says ASIC's senior executive leader for consumers, advisers and retail investors, Delia Rickard. "It is a time when it makes sense to get advice and we want to make sure that they are getting good advice."

According to Elise Payzan-LeNestour, lecturer in Finance at the Australian School of Business, there's plenty of evidence to suggest that people's analytic cognitive function begins to decline from age 20. This makes good financial advice for older people imperative. Payzan-LeNestour, whose focus is on neuroscience research, says the relationship between quality of decision-making and age has a U-shape: young investors and old ones are more vulnerable to making financial mistakes than mid-age investors, the optimal age being in the late 40s and early 50s.

According to the 2010 Intergenerational Report, the proportion of people aged 65 years or over is projected to increase from 13% or 3 million in 2010 to 23% or 8.1 million by June 2050. A large portion of these people are expected to leave the workforce and when they do they will have varying amounts of money saved for their retirement – which they may or may not know how to invest appropriately.

The latest Australian Bureau of Statistics data shows that the median total superannuation account balance for men in 2007 was A$87,500 and A$52,000 for women. Median superannuation account balances for people aged between 55 and 64 were almost A$165,000. For people aged between 65 and 69 superannuation account balances were about A$268,000 and for people aged 70 and over the balances were about A$232,000.

While median individual balances may be relatively small, the total amount of money expected to find its way into retirement products in the decade is considerable. According to ASIC, about 20% or A$240 billion of the A$1.3 trillion super pool is in retirement products and this is likely to double over the next decade. Much of this will be handled by advisers.

Planning for Change

In addition to those people with superannuation account balances sufficient to self-fund their retirement, an estimated 80% will at some stage in their retirement be relying on the government-funded age pension to survive, says Rickard. Given the complex decisions around understanding financial products that are available and how they interact with the social security agency, Centrelink,

and the Australian Taxation Office, it's important that people get good advice, Rickard says. "We know that people's plans change, they may end up retiring earlier than they thought, but there is no planning for that. Suddenly they find themselves in complex and unfamiliar territory. There is a big potential for problems to arise."

Council on the Ageing chief executive Ian Yates, who is also a member of the ASIC Consumer Advisory Panel, has welcomed the latest review. The review will put the spotlight on whether the advice that is being given to a particularly vulnerable group of people is appropriate given their circumstances, says Yates. "The vulnerability comes from suddenly having a large amount of money which is not replenishable and having to deal with the concept of investing possibly for the first time," he says. "If someone is not literate in the world of investing then they are vulnerable to a person who doesn't have their best interests at heart. It is not that an adviser may be trying to defraud them, but that they are not explaining sufficiently that some investments carry significant risks that may not suit their position. These people have accumulated super that has to last them a long time and it is not replenishable," says Yates.

Rickard says the main aim of the review, the results of which will be released in the first quarter of 2012, is to work with industry to paint a clear picture of what should be good advice. She says good quality advice around when to retire, how pension eligibility affects other retirement decisions, how certain investment products work and longevity strategies can make a huge difference to someone's retirement income.

"We also know that if you are armed with the right questions to ask you will get better advice," she says.

A recent survey shows that people who do get financial advice are more likely to be on track to meet their retirement goals. But they are also likely to worry more about their financial situation. Investment Trends chief operating officer Tim Cobb says based on the results drawn from the Investment Trends 2010 Retirement Income Report, people who use advisers post-retirement are less likely to be worried about the cost of essentials in retirement, but more worried about market and longevity risks. People's increased concern about falls in financial markets or their money running out because they expect to live a long time, may come from being better informed about potential issues, Cobb says.

According the report, half of the respondents who use a financial planner say they are definitely or reasonably on track to reach their retirement goal compared to one-third of those who don't use financial advisers.

Definition Required

The advice review comes amid a push by the Financial Planning Association (FPA) to the federal government to restrict the term "Financial Planner" to members of an approved professional association. According to FPA chairman Matthew Rowe, under the Corporations Act there is no constraint on people calling themselves financial planners irrespective of their training or competence, unlike other professionals such as stockbrokers. "There are 16,000 financial planners in this country, of which 8000 are FPA members who are bound by our code," Rowe told a recent gathering of advisers in Sydney.

"We estimate that 2000 planners are members of the accounting profession bodies. This means there are 6000 financial planners or more than a third that are working in an ethical or professional vacuum."

The Association of Financial Advisers, which has 7000 members and a strict code of ethics, has also called for the term to be restricted. Richard Klipin, chief executive of the association, says it had flagged the issue early on, asking for the term "financial adviser" to be legally defined in a submission to the Ripoll inquiry, and had argued it with Treasury and government ever since.

"From a consumer point of view it's around trust in what advisers deliver and clarity around the term," he says. "We look forward to the day when that actually happens."

Financial Services Minister Bill Shorten has said he would take the debate to the federal government.

"Without making any commitments, I'm certainly open to investigating the pros and cons of regulating the term 'financial planner'," he says. The government has been active in its attempts to provide better protection for consumers when it comes to financial advice. The Future of Financial Advice reforms announced in April will require financial advisers to get clients to "opt-in" every two years if they wish to continue receiving ongoing advice. They will also ban all commissions on risk insurance inside superannuation and prohibit volume-based payments.

A ban on upfront and trailing commissions associated with financial products will come into force on 1 July 2013.

According to Shorten, the reforms were designed to provide further protections for consumers of financial advice and to restore trust in the system with the collapse of financial service providers such as Storm, Trio and Westpoint still fresh in many investors' minds

Almost 14,000 investors lost a combined A$4.8 million when Queensland-based Storm Financial collapsed. Storm was able to produce impressive returns for investors by advising them to borrow heavily to boost the performance of their portfolio. The business model worked brilliantly while markets were soaring, but when the financial markets turned following the 2007 global financial crisis loans had to be repaid quickly and Storm collapsed.

Westpoint Corporation paid high commissions to advisers who lured investors to a high-risk, high-interest paying property investment scheme – now known to be a Ponzi scheme in which investors' own money was used to pay their interest. Almost A$305 million was invested by 3524 unsuspecting people in a series of funds, all of which collapsed.

While the vast majority of financial advisers are dedicated professionals who give good advice to the best of their abilities, Shorten notes that does not change the fact that many consumers lacked trust in the profession and there was a perception that advice was under-regulated and open to abuse. "It is a concern that only one in five Australians seek financial advice," says Shorten.

"These reforms are designed to encourage those people who have doubts and concerns about the value of such advice, or who have just never thought about it – those other four in five people – to perhaps in the future get financial advice."

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