Financial Planning in Australia

Chapter 19 — STATEMENT OF ADVICE CONSTRUCTION

Solutions to Questions

Question 1

The life stages that have been identified are:

- Savings versus consumption phase — generally younger people, trying to get established, new jobs, wanting cars, saving for house, enjoying life. If they are not careful, they can get over their heads in debt and find that their credit rating is poor.

- Early family formation — people with young families, both partners may be working, issues with mortgage payments, childcare, school fees, need for insurance, trying to stretch their budgets. Illness of either partner or any children could mean high unexpected costs and stop any savings that they were able to achieve.

- Wealth accumulation phase — generally families where the mortgage does not take up so much of their income, career positions, earning higher salaries, balancing work and leisure, assisting their children and saving for their own retirement. Death or disability of the client(s) without adequate insurance protections would mean that hard won savings would have to be used to fund current expenditures.

- Approaching retirement phase — generally associated with people in their early 50s to age 65. People seeking to maximise their retirement savings so that they can comfortably fund their retirement income needs. The client is made redundant and their savings stop. They may have to draw from personal savings to meet current needs.

- Post-retirement phase — managing their retirement savings to ensure a satisfactory retirement income. One partner dies, leaving the other partner in reduced circumstances.

Question 2

1. Where are you working?
2. How secure do you feel that job is?
3. How much are you earning?
4. How much is your employer contributing to your superannuation savings?
5. Are you contributing extra to your superannuation savings?
6. What investment option is your superannuation savings invested in?
7. What is your current balance?
8. What level of income do you expect to need in retirement to be comfortable?
9. At what age are you considering retiring?
Question 3

Because people are more likely to read something that is about them, it is important to put information regarding the client in the letter. Including their main goal is one way. Another is recognition of family circumstances — that is, children or other dependants. A positive outcome, even if the client has to make trade-offs, is also important. You could also include the reason(s) the client came to meet with you. For example, if the client was referred to you, you could say something about how you appreciate the referral. Even though for all practical purposes this is a standard form letter, taking the time to personalise it will make the client want to read on.

Question 4

Ramona and Andrew, I have asked each of you to take a standardised, web-base risk tolerance assessment. This assessment offered you the opportunity to indicate what you thought your risk tolerance was in comparison to others. It then asked you a number of questions about past investment experiences and what you would do in certain circumstances. It then asked you to consider a portfolio mix that would be within your comfort zone. The assessment scored your answers against that of a large number of people and provides you with a numerical score and an indication of what risk tolerance group you might fit within. In addition, it detailed where your answers were different from that group.

I will use the scores, the grouping and the areas where you scored different to your group to discuss with you your investment and other risk-associated needs. It is important that you are comfortable with the advice that I provide you.

Question 5

Clients have a right to know both what they are paying for the advice and what benefits the financial advisor and the dealer group received. They need to know if any payment or benefit might cause a bias in the advice that they have been given and then determine if that bias did in fact happen and was detrimental to them. Therefore, over time, a stricter disclosure regime has evolved. Clients now should receive both a % and a $ value of the fees and commissions that they will pay, and details of how the financial advisor and the dealer group are remunerated for their services.

Question 6

While the specific actions will be different for each plan, implementation will cover such things as:

- All actions the client must undertake, such as increasing their salary sacrifice or switching their investment option within their superannuation fund, must be recorded. This means that the financial advisor obtains copies of the letters confirming that the client’s actions have been completed.
- Assist the client to complete all application forms and attach the appropriate cheques, drawn to the correct name.
- Follow up to ensure that appointments with solicitors, insurance brokers or other service providers have been kept and obtain copies of any resulting advice.
- Where automatic investment programs have been recommended, assist the client to complete the appropriate direct debit forms.
Question 7

Disclaimers should probably not be seen as ‘a defence’, but rather another opportunity to discuss with the client the role of assumptions, projections, the uncertainty of investment markets etc. Where the client is walked through the disclaimers and understands the risks involved and the importance of annual reviews, they will be less likely to panic when negative events happen. They will have been warned.

Solutions to Problems

Problem 1

The instrument should allow the client to indicate how they feel about such things as investment volatility and taking chances on tax deductions. It would be good to know if they have had any investment experience in the past, and how they felt about it. It would be good to know what investment option they have within their superannuation fund and what experience they have had with its return. It would be good to know how long they had to achieve each of their goals. They should also be asked about their attitude towards debt and making interest payments. They should be asked what their expectations for different markets are. They could compare how comfortable they would be with modest and larger losses in their investments.

Problem 2

<table>
<thead>
<tr>
<th>What action?</th>
<th>Who to complete?</th>
<th>What documentation?</th>
<th>What money transfer?</th>
<th>When to be done by?</th>
<th>Who to assist</th>
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<tr>
<td>4 Obtain Insurance Plan</td>
<td>Mr and Mrs</td>
<td>Copy of Financial Plan</td>
<td>Insurance Broker</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obtain an Estate Plan</td>
<td>Mr and Mrs</td>
<td></td>
<td>Solicitor</td>
<td></td>
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</tr>
</tbody>
</table>

Problem 3

The Statement of Advice summarises the grounds upon which the advice has been based, the goals and objects to be achieved, the strategies agreed upon to meet these goals, the risks and benefits, the affordability of the financial plan, the costs associated with implementation and the remuneration and benefits the financial advisor and dealer group will receive. It is important to have this document in writing for both the financial advisor and the client, as they can work through it together. The client can make notes, ask questions, and get more information. Once the client signs off on the plan, the financial advisor has a record of the advice given and the fact that the client has agreed to implement the advice. If at a later time there are any issues, this document will, assuming that it is written properly, afford the financial advisor a written record of the advice, the basis for the advice and the client’s agreement to proceed.
Problem 4

The first thing they need to look at is their assets and liabilities. They are in debt for $210,000. Second, they need to look at their cash flow. Using the 2006 tax rates and assuming that each claims $50,000 of the net business income, they will have an after-tax income of just over $78,290. They have general living costs of $60,000, so they technically have $18,290 pa in excess savings capacity. If the business will not generate the same revenue with John no longer working, Renee’s income will not meet the living expenses. If the business will still generate the $100,000 but it is all in Renee’s name, the family income after tax will drop to approximately $69,420. That is not really much of a buffer for a family with two small children and does not take into consideration any educational costs.

Problem 5

These people are going to need to access social security to make their retirement savings last. They will also need to look at any social security benefits that Jessica can claim. They need to formally appoint a guardian for Jessica in their will. While their married son would be an option, they would have to discuss this with their son and his wife. They should also investigate a special protective trust within their will to hold money for Jessica’s future expenses.

If Stephen is still working, he might try to increase his superannuation savings and Louise might look at opening a superannuation account for herself — perhaps using the existing investments.

Assuming that they can increase their total superannuation savings to, say, $600,000 over the next five years, they could achieve a retirement income of possibly $45,000 in today’s dollars, including a part pension. If that amount exceeds their needs, they could use the excess money to fund Jessica’s future needs. Alternatively, they could establish a protective trust using the personal assets and continue to grow their superannuation. If their son was the trustee, he could continue the responsibility when Louise and Stephen die.

Each option would have to be tested against what they can do and what can legally be put in place. Much of the strategy depends on the son’s willingness to assist in the longer term care of Jessica.