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How to road test your financial planner

Like lawyers, accountants, dentists, and other professional service providers, financial planners are in business to make money. As well as the need to earn a living (on industry average about $110,000 pa)[1] they need to cover their administration, legislative and compliance costs, and generally, contribute to company profit.

So – how do you know if your financial planner is going to go the distance?

In 2019 the difference between having a financial planner and going it alone was calculated at about 3% of ‘alpha’ per annum, or an extra $3,000 per $100,000 in returns[2]. In the words of Mark Twain (and as InvestSMART readers would be aware) “there are lies, damned lies and statistics”.

The potential to achieve a higher portfolio return should not be the only reason to engage – or assess the worth of – your financial adviser.

To my mind, there are three simple tests. They relate to personal compatibility, fees (including investment and advice fees) and the service offering. Each of these factors are equally important – so let’s dive a little deeper.

Personal compatibility

Your financial planner doesn’t have to be your ‘buddy’ – but as in any relationship, mutual respect and trust is the vital ingredient – particularly if you are to rely on the advice being provided. Your planner should always be available to take and return your calls, regardless of your investment balance. This is mutual respect in practice.

Observe relationships and culture within the business, and the treatment of staff. If your adviser is rude or surly, this is probably not going to be the best long-term fit. As humans, it is my belief that a financial relationship is the second most intimate relationship we can have – so if you don’t get on, don’t go there.

Assess educational habits and achievements. Does the adviser have more qualifications than the basic requirements? Is he or she intellectually curious? In the current dynamics of providing financial advice, you need more than a ‘bush carpenter’ when it comes to taxation and Centrelink, as this interface is important to the quality of advice.

That said, determining whether your adviser is appropriately qualified will become less of an issue in coming years, as significant increases to industry education standards, in the wake of the Hayne Royal Commission, take effect. From 1 July 2019, all new advisers entering the industry will need to hold a financial planning degree; existing advisers who do not take steps to upgrade their qualifications within a prescribed timeframe will not be able to practice.

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[1] https://www.seek.com.au/career-advice/role/financial-planner accessed 4 June 2020
[2] https://static.vgcontent.info/crp/intl/auw/australia/documents/resources/adviser/quantifying_adv_alpha.pdf accessed 4 June 2020

Fees

The total of all fees ie, investment charges and advice fees should be below 1.5%. If you are going to be 3.0% better off in return terms, make sure that this is ahead of all the other costs.

Ensure that your adviser is able to demonstrate clearly how value is being added based on the dollar amount being charged, and the NET returns you get as a result of the advice provided.

If a strategy is sold to you as a saving of 3.0% but the fees are in dollars, smell a rat. A fixed hourly rate, or a flat dollar fee for service is the best approach to achieve complete transparency.

Expect to pay for a ‘Statement of Advice’ in the same way you would expect to pay for a Will redraft or a tax return. Similarly, if a new strategy is being developed, there should be a time cost for development, legal and technical soundness, and implementation – as well as a profit component.

Service offering

The bulk of the cost – in fact the loss-making part of a financial adviser / client relationship lies with the engagement of new clients, where ‘complimentary’ first meetings must be followed by a rigorous discovery process. Authorisations are prepared and executed to verify financial information, data records established and working papers documented; followed by any number of subsequent face-to-face-meetings in the development and implementation of a suitable financial strategy.

In my experience, it takes around three years into the billing cycle before a client becomes ‘income generating’ for the firm. Prior to that, engaging a new client comes at a not insubstantial cost.

The level of ongoing service can be negotiated by the type of service package required, or the service level which is appropriate to client circumstances. A competent financial adviser will usually have three or four well defined service ‘tiers’ related to the level of annual service required. If you are likely to be a very active client requiring a high level of service, expect to pay the most. If you just plan on ‘relaxing in retirement’ you will probably pay the least.

Warning signs

If your adviser appears self-focused, fee driven or inefficient and doesn’t return your calls, it is time to move on.

This decision may come at a cost, however staying with a financial adviser who is not the right fit will cost you more in emotional terms than the dollars involved.

Ineffective advisers should be disengaged, in the same way that you would not go back to a medical practitioner whose treatment was unsatisfactory.

Having a financial adviser can deliver $30,000 in upside (or alpha) on a million-dollar retirement savings pool. Make sure it is worth the hassle.

For most people, the most common reason for seeking a financial planner is grounded in the realisation that they “don’t know what they don’t know” when it comes to negotiating the complexities of the retirement savings/taxation and Centrelink interface. They are really buying peace of mind by employing someone who does. The ‘alpha’ is usually an unexpected delight.

Theo Marinis is Managing Director of Marinis Financial Group

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For further information, please contact:

Theo Marinis B.A., B.Ec., CPA., CFP®
Financial Strategies (SA) Pty Ltd
Trading as Marinis Financial Group
T 08 8130 5130
F 08 8331 9161
E admin@marinisgroup.com.au
W marinisgroup.com.au
A 49 Beulah Road
NORWOOD SA 5067

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