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Holland & Holland

EST. 1978

SPECIAL REPORT NEWSLETTER



INTRODUCTION

Following the recent Royal Commission into the Misconduct (Not Conduct) of the Banking, Superannuation and Financial Services Industry, I would like to clarify some of the mis-truths and rhetoric which have been reported in the press.

I would also like to emphasise how important I believe it is to get good quality financial advice, the important role small business plays and the importance of trust and ethics in this debate.

I am not going to make excuses for the banks and AMP. Things went astray the day the banks and AMP began to vertically integrate for profit.

By doing so, they aggregated advice and products i.e. Wrap Accounts and Master Funds, Insurance and Funds Management and the die was cast.

Fast forward 20 years and the banks are all exiting the advice business and going back to basics, Deposits and Lending.

Where does this leave AMP? Who knows? Their business model is broken.

David Murray, the ex-CEO of CBA, a very well regarded and respected member of the finance community, has been appointed AMP Chairman. David has a long hard slog ahead of him.

AMP's new CEO, Francesco De Ferrari and head of Wealth Management, Alex Wade, have designed and are adopting a three-tiered approach to providing financial advice.

In this version, the low end would be served by digital, middle ground clients would be served via the telephone and the high end by advisers.

This big structural change will see approximately 750 AMP advisers displaced.

I would also like to dispel some of the myths surrounding Industry Super Funds and to give you some insight into the Industry Funds, namely QSuper.

Industry Funds got off relatively scot free during the Royal Commission and are now the beneficiaries of new members moving from Retail Super Funds and Self-Managed Super Funds (SMSFs). Let us not forget William Shakespeare's famous quote "All that glitters is not gold", when it comes to Industry Super Funds.

A section of the public has lost 'Trust' in the Banks and Financial Advisers in general. It is now up to the Financial Planning Industry to win this trust back.

Small businesses like Holland & Holland have always acted professionally, ethically, honestly and in the best interests of their clients. I am now Self Licensed, which means that I have no 'Conflicts of Interest' when it comes to the products I use as part of my advice.



Trust-Ethics-Professionalism

Approximately 20 years ago the banks took a very calculated leap of faith by buying and integrating Wealth Management, Funds Management, Wrap Accounts and Masterfund Platforms and Life Insurance into their businesses:

- CBA purchased Colonial First State
- Westpac purchased BT Financial Group
- ANZ purchased ING Group
- NAB purchased MLC and Navigator

AMP did the opposite. It was already running an integrated wealth management business model and then moved into the banking territories of Deposits and Lending.

While on face value this appeared to be a legitimate commercial strategy, it ultimately led

to dishonest practices, bad press, fines, losses and conflicts of interests.

Small business advisory firms were not immune. They too joined the banks under the dealer group model.

Twenty years later it culminated in the Royal Commission and exposed the ugly truth of profit maximization for the benefit of shareholders and led to broken trust. It also highlighted the significant conflicts of interest, of acting in the client's versus shareholder's 'Best Interest'.

Again, I must emphasize that the Royal Commission was investigating Misconduct not Conduct and the main perpetrators of this Misconduct were the four major banks and AMP.

Ethics

Ethics can be characterised as the science of conduct or values management - specifically moral values, which include concepts of respect, honesty, fairness and responsibility and how these values are applied. (BRANDL et. Al. 2002)

Faced with an ethical issue, individuals must reflect on competing moral standards to try and determine what is the right moral decision to make.

The four major banks and AMP's advice models were flawed. Sales targets, profits and shareholder returns muddled the waters and priorities were given to performance-based metrics without due consideration for the clients' 'Best Interests'.

While small business professional advisers are in business to make a profit and grow, the major difference here is 'Culture'. The clients' 'Best Interests' are PARAMOUNT!

We heard this term 'Culture' referred to often during the Royal Commission.

The distinct advantage that small business professional advisers have over larger advisory groups such as Industry Funds and retail banking financial advice is Trust, Ethics and Service.

A study in the characteristics of Trust in personal financial planning, conducted by the University of Western Sydney's Dr Michelle Cull and Terry Sloan, in 2016 concluded that trust is defined as: the Adviser (trustee) acting honestly, competently and in the best interest of the client (trustor).

Cull & Sloan (2016) identified seven primary characteristics of trust that they concluded were essential to the client/adviser partnership:

- Vulnerability
- Feelings
- Honesty
- Faith
- Best Interests
- Accountability, and
- Competence

These values and traits should now be the focus of all financial planning business models, large or small, in order to re-build trust and to re-establish the trust in the client/adviser relationship.

This however, is a difficult challenge for the larger dealer groups and Industry Funds because of their business models. For example, there is no client/adviser relationship between an Industry Fund call centre operator and the Fund member.



Dispelling some of the myths surrounding Industry Super Funds and Retail Super Funds.

Myth No. 1

Fees

Fees are lower/less for Industry Super Fund Members compared to those of Retail Super Fund Members.

Not true.

If I use four funds from the QSuper options on offer as a comparison:

Name of Fund	Total Fee
1. Lifetime Outlook (age <40 years)	1.05%
2. Lifetime Aspire (40-49 years)	0.90%
3. Balanced	0.95%
4. Aggressive	1.02%

Note: Total fees represent Administration and Investment based fees + Investment Performance based fee + Indirect Cost Ratio (ICRs).

When you compare these fees with say Asgard's new Open eWRAP Super account, using a diversified portfolio, representing a 'Balanced' Asset Allocation, there is very little difference:

Administration	0.25%
Fund Indirect Cost Ratio (ICRs)	<u>0.75%</u>
	1.00%

Small business professional financial advisers are able to reduce the Fund Manager ICR by using Direct Equities, Exchange Traded Funds (ETFs) or Listed Investment Companies (LICs).

Retail Super Funds have also started to negotiate lower ICRs directly with the Fund Managers. Asgard, for example, has done this, which benefits the member in the long-run.

A number of the Fund Managers have started to offer very low ICRs, say 0.20%, with a



Performance based fee, if they can outperform certain benchmarks.

The BlackRock Global Allocation Fund did this when their fund was first launched in Australia in approximately 2005, and many Fund Managers have followed suit.

This represents a real WIN WIN for the Fund Manager and the super member. If the Fund Manager produces good returns over and above a certain benchmark, the client is rewarded with a superior return, and the Fund Manager receives a slightly higher fee for outperforming the relevant benchmark.

On the flip side, if they don't achieve their benchmark return or better, their remuneration is the lower 'base' fee.

Ongoing Advice Fees

Small business professional advisers charge their clients an ongoing fee to manage their portfolios, hold annual review meetings and to provide a range of other advisory services. This revenue also assists with the typical overheads of running a small business. Other associated costs relating to financial planning also include professional development and training as well as regulatory and compliance costs.

Small business owners are in business to service clients as well as make profits and hopefully grow the business.

Profit Margins are a function of two things:

1. The cost of doing business.
2. The value the client sees in the services that I offer.

Small business professional advisers typically charge a percentage based fee on the balance of the funds they are managing on behalf of their client.

OR

A designated Fixed Fee i.e. Fixed Retainer.



My Ongoing Service fee is generally between 0.5% and 1%.

I also charge a fee for a Statement of Advice.

My Statement of Advice fee ranges from \$1,000 to \$3,000 (dependent upon complexity).



QInvest, the advisory arm of QSuper, also charge Statement of Advice and ongoing fees. Their Ongoing Service fee is between \$1,900 and \$2,600 p.a.

QInvest's Statement of Advice fee:

\$0 - \$3,000	QSuper Members
\$3,500 - \$5,000	New Members

*Reference: QInvest Financial Services Guide
Issued: 15 April 2019.*

On balance, there is very little difference between the fees paid by QSuper members and my clients here at Holland & Holland.

The key difference being that I have a relatively small number of clients which I service versus QSuper's 565,000 members.

My clients get comfort in knowing that they can simply pick up the phone and call me (or Peter Dann or Jennifer Schulze) directly, e-mail me, or visit me in person. Access to myself and my staff is important and provides our clients with peace of mind.

Again, there is no comparison between Industry Super Funds and small business advice professionals such as Holland & Holland when it comes to service.



Myth No. 2

Returns

Returns of Industry Super Funds are superior to those of Retail Super Funds.

Answer: It depends!

When meeting with potential new clients, I am often asked the question:

"Peter, if I engage you as my Financial Adviser, will the performance of your portfolio exceed that of my current Super Fund?"

My stock standard answer is:

"It depends".

Firstly, I never commit to achieving certain returns. This is only setting you up for failure.

In my discussions with potential clients around Risk Profiling and Asset Allocation, I focus more on long term objectives of exceeding inflation i.e. a 'Balanced' Fund's objective may be to exceed inflation by 3%-4% over the medium to long-term 7-10 years.

I may also discuss potential yield or income of the portfolio, which is important to clients, particularly in retirement i.e. pension phase.

No one can control or predict financial markets. Our return objectives need to be realistic.

In a paper written by Phil Graham (an independent investment committee member and until recently was Deputy Chief Investment Officer with Mercer) published on cuffelinks.com.au in December 2018, Phil outlined four reasons why investment comparisons are flawed.

Excessive focus on the short term

The media and survey providers typically grab headlines by analysing 1 year's performance results typically each July (for Financial Year) or January (each Calendar Year).

The fund managers who build these portfolios know that they are designed to deliver over the long-term and funds should be judged on 5 and 10 year performances, not twelve months.

Ignorance of investment objectives

Funds are typically judged on peer relative performance measures as opposed to performance against an objective. This gets back to the point I made earlier.

Even the bottom quartile funds in the Super Ratings Survey had delivered 7.8% p.a. over a 5 year period and 8.5% over a 10 year period to June 2019 (Includes the GFC) against an investment objective of approximately 5.5% (based on CPI + 3.5%). The fact that almost all funds would have achieved their stated investment objective, even including the GFC period, is completely ignored.

Major differences in asset allocation within the same risk profile

"Compare an apple with an apple, not with a pear".

Given the increase in advertising in recent years by Industry Super Funds, many Retail Super Fund members have been comparing the performance of their fund to the various Industry Funds.

However, due to limited information and no Industry Standards as to the Asset Allocation mix

for various funds such as 'Defensive', 'Moderate', 'Balanced', 'Growth' etc., this comparison is not straight forward and can be misleading.

A list of the comparisons the ratings agencies publish in the press, focuses on comparing 'Balanced' or 'Growth' funds. However assets, either Defensive or Growth, and their percentage weighting, which constitute a 'Balanced' or 'Growth' fund, are not standardised.

Some Fund Managers or Asset Consultants advocate 40% Defensive Assets and 60% Growth Assets, while others advocate 20% Defensive Assets and 80% Growth Assets for their respective so-called 'Balanced' funds.

This is a very wide range, however both call themselves 'Balanced'.

During rising or falling equity markets, a higher or lower exposure to Growth Assets (such as shares), will improve or hinder performance.

A trend line of fund returns against growth asset levels suggest that a 10% increase in growth assets (from 65% to 75%) produced a 1% higher return over five years and a 0.5% higher return over 10 years.

This is enough to move a fund from 3rd quartile to 1st quartile over both time periods, which is a massive difference in performance ranking.

To further complicate things, Industry Super Funds investment portfolios exhibit a low level of transparency. As a result, investors have little clarity as to what they have invested in and where the risks lie.



If we analyse QSuper's Lifetime Focus 1 Fund:

<u>Asset Class</u>	<u>Asset Allocation</u>	<u>Ranges</u>
Cash	15.5%	0 – 25%
Fixed Interest	<u>21.5%</u>	5 – 35%
Total Defensive Assets	37.0%	
Real Estate	7.5%	0 – 20%
Equities*	32.5%	25 – 55%
Infrastructure	15.4%	0 – 20%
Commodities	1.6%	0 – 15%
Alternative Assets	<u>6.0%</u>	0 – 25%
Total Growth Assets	63.0%	

*Equities include:

Australian Shares	6.2%
International Shares	21.1%
Private Equity	5.2%

The member is given little or no information or what exact assets make up Real Estate, Infrastructure, Commodities, Private Equity and Alternatives.

In a paper written by Adrian Pelligra, Private Wealth Manager at Akambo Private Wealth, he raises similar concerns:

“A survey conducted by Chant West found that Growth Funds in 2017 received a median return of 10.8%, however, they were greatly outperformed by the leading 5 Industry Super Funds, with an average return of 13.2%.

What explains the higher returns of Industry Super Funds?

Growth and Defensive Assets

Disproportionate allocations of clients' money to Growth Assets such as Property, Infrastructure and Alternatives, are questionably labelled 'Defensive'.

Host Plus for example:

76% Growth Assets + 24% Defensive Assets.
Host Plus lists the following assets as 'Defensive':

Cash	0%
Fixed Interest	2%
Property	9%
Infrastructure	5%
Credit	6%
Alternatives	2%

Firstly, it is quite concerning that there is little or no allocation to Cash & Fixed Interest.

Also I would argue that Property, Infrastructure and Alternatives are 'Growth' assets.

In reality, this is closer to a 'High Growth' Asset Allocation.

Risk-adjusted Returns

When comparing returns of super funds, no consideration is given to risk - adjusted returns.

The Industry tends to focus on headline or average returns, without focusing on the inherent risks of the portfolio.

Comparisons of super funds should focus on risk as a key metric.

Disclosure Concerns

Super funds are not required to disclose how they classify their investments, i.e. Defensive or Growth not even to Australian Prudential Regulatory Authority (APRA) or Australian Securities and Investment Commission (ASIC).

Transparency

The Infrastructure, Property and Private Equity holdings held within QSuper and Host Plus are held in unlisted vehicles which raise concerns of valuation and liquidity.

Comparing Apples with Apples

With all the laws and consumer protection we have in place in Australia, we still don't have a standardised format for:

1. The label of Super Funds products i.e. Conservative, Balanced, Growth, etc.
2. What assets constitute 'Defensive' or 'Growth'."

Jeremy Cooper who was chair of a comprehensive review of Australia's super system (Cooper Review), and is currently Chairman, Retirement Income at Challenger, was quoted in the Financial Review on Wednesday 24th July 2019 saying:

"He has backed calls for more stringent reporting standards for Superannuation funds including uniform definitions for Growth and Defensive Assets".

"Some Super funds have been accused of mischaracterising growth assets as defensive ones, which make returns look better while masking added risk".

"We haven't got a good way of ranking returns associated with a highly risky product and a low risk product".

The typical 'Balanced' fund here at Holland & Holland, which I construct based on research provided by Morningstar, looks something like this:

30%	Australian Shares
24%	International Shares
10%	Property & Infrastructure
7%	Alternatives
5%	Cash
24%	Fixed Interest

Funds or Direct Equities used are all fully disclosed.

Every fund and share is fully transparent and backed by Institutional Research provided by Morningstar.



Myth No. 3

Insurance

My Industry Super Fund has the added member benefit of offering Life/Death, TPD and Income Protection Insurance.

True – But with limitations

We have seen first-hand where Industry Super Fund members have gone directly to so called Insurance Claim Specialist Lawyers when they believe they have a legitimate claim, based on an insurance policy held inside their industry super fund.

The typical fee charged by said Law firm for this service is anywhere between 15% - 40% of the total claim.

This scenario is playing out more and more, and to the detriment of Industry Super Fund Members.

Cost

Traditionally, the cost of Retail cover was more expensive than Group cover (Industry Fund Member cover). Now however, as the number of claims increase across the board, Group Insurance providers are being forced to accommodate those who may be low risk, under the same premiums as those who are high risk. Premiums within Group cover have increased significantly, while their policies are inferior to those from retail cover.

Parties to the Insurance Contract

Group cover is generally a contract between the Superannuation Trustee and the insurance provider, not YOU and the insurance provider. This means, that as premiums increase and more claims are paid, definitions continually change without your authority or knowledge. Definition or policy wording changes may be the difference between a successful or unsuccessful insurance claim.

Retail cover however, is a contract between you and the insurance provider where they CAN NOT change the definitions or claimable events once the policy is in place, unless it is an enhancement to the policy.

Underwriting

Group cover is typically not underwritten at the time it is being provided which poses the risk of a claim not being paid due to non-disclosure or a pre-existing medical condition.

Retail cover however, is always underwritten prior to you paying premiums. This ensures that you are not paying for a policy that may be declined at claim time, as long as your full disclosure obligations have been met. This is where an adviser will assist greatly in the advice process.

Definitions

Flexibility of insurance providers within Industry Superannuation Funds is also very limited. They cannot offer levelled premiums, agreed value Income Protection or Own Occupation Total and Permanent Disability cover, which all have a huge effect on the type of policy you end up with. Typically speaking, their policies have inferior definitions and represent the 'bare bones' cover.

Claim Time

Settlement claims can also be very difficult, from our experience group cover can take up to 6 months longer to pay out compared to retail cover. There are a number of reasons for this.

Firstly, group cover is not underwritten and a lot of the time, the underwriting is done at claim time and not prior to you paying for premiums. This is a huge concern. Retail cover claims are fully supported by your Adviser. We have found that the claims our insurance partners have processed for our clients who have retail cover, have been far more seamless, less paperwork and have not required lawyers or solicitors (ever!). One of the insurance referral partners we use has a 100% claim rate for clients, which shows just how valuable retail cover really is. Lawyers are rarely required for any insurance claim, however they seem to use scare tactics to proclaim to assist with the claim and then charge anywhere between 15 and 40%, for their efforts. Especially with retail cover, you should never need a lawyer, which is what your Adviser is there for.

Secondly, working with Superannuation Trustees is an extremely difficult process to go through, especially when it is at the point where you need the money the most. Superannuation Trustees provide many hurdles to jump through in the event of a claim to ensure that the 'Condition of Release' is being met, regardless of the purpose of the cover and the potential terrible circumstances the claimant may be experiencing at that time of claim.



Myth No. 4

Advice

My Industry Super Fund gives me “Free” Advice.

Wrong!

A large number of Industry Super Fund members are under the impression that because they can pick up the phone and ring the Call Centre to find out information on their Super account, that they are therefore receiving advice for free.

When a member rings, the Call Centre (and after possibly waiting up to one hour for a Call Centre person to talk to you), they can only give you what is called ‘General’ information with regard to your Industry Super Fund. They may well read a Disclaimer Statement to this effect.

If you are a member of QSuper for example, and you require Financial Advice, you will be referred to the Financial Planning arm of QSuper, QInvest.

Over the years at Holland & Holland, we have seen situations where our clients have phoned QSuper to get information on their fund or to ask questions regarding contributions or withdrawals. The Call Centre operator has given them information and then based on this, the clients have acted on it and it has resulted in either a tax penalty, or generally has had a negative consequence.

The Call Centre staff either do not qualify or clarify the question, or ask their own questions which means the enquirer is acting on incorrect advice/information. Instead they rely on the General Information Disclaimer which does not take into account your full Financial situation.

An ASIC report has found many consumers are confusing ‘general’ and ‘personal’ advice, exposing them to greater risk of poor financial decisions.

ASIC’s financial advice ‘*Mind the gap*’ report used hypothetical advice scenarios to test consumer recognition of when general and personal advice was being provided and awareness of adviser responsibilities when being given each type of advice.

It found that only 53 percent of those surveyed could correctly identify ‘general’ advice. Even worse, only 19 per cent of those surveyed could correctly identify ‘personal’ advice.

Even when provided with the general advice warning, nearly 40 per cent of those surveyed wrongly believed the adviser had an obligation to take their personal circumstances into account.

ASIC Deputy Chair, Karen Chester, said “the disturbing gap in understanding whether the advice they are getting is personal or not means many consumers are under the false premise their interests are being prioritised, when no such protection exists”.

ASIC said it anticipates the need for financial advice to grow, reflecting an ageing population and many financial products, especially retirement products becoming more complex.

It reports that much of the advice is likely to be general advice, and while appropriate in some circumstances, it is inevitably of limited use.

And whilst the financial services Royal Commission, and the government’s response, dealt with the most egregious risks of hawking of complex financial products, consumer confusion about what is personal and general advice needs to be addressed.

In addition, Ms Chester said “the consumer research is timely, and comes as the government is considering policy recommendations on financial advice from the Productivity Commission’s twin reports on Australia’s financial and superannuation systems”.

“It’s at a time when the financial system itself undergoes much change, following the intense scrutiny of the financial services Royal Commission, including considering new financial advice and distribution business models”, she said.

The ASIC report is the first stage in its broader research project into consumer experiences with, and perceptions of, the financial advice sector.

ASIC said it would undertake additional research in 2019 to identify a more appropriate label for general advice and consumer-test the effectiveness of different versions of the general advice warning.

Conclusion

The purpose of this 'Special Report' Newsletter is not to denigrate or disparage Industry Funds and their members or the retail banking financial planners but to give a more 'Balanced' view on the issues raised in the press and media of late.

The Industry Super Fund model, whilst flawed on some levels, works well for a number of its members.

I strongly believe that your Super is an investment in your financial future, and shopping around for the lowest cost solution is not the answer.

Small business financial planners, such as myself and many of my colleagues, are in business to provide a service and to give you professional advice on a topic that has a significant impact on your standard of living in retirement.

Yes, there is a cost to engage a small business financial planner, but again this cost needs to be seen as an investment in the success of your financial future, not just an unjustifiable fee.

Following the Global Financial Crisis, and various Enquiries and Commissions into Financial Planning and Superannuation, the regulatory and compliance costs involved to service clients has risen dramatically.

Ironically the Government and Regulators are adding to the costs involved in providing financial advice, which means that the people who need it the most, unfortunately cannot afford it.

Financial Advice - An Investment in your Financial future

A common misconception is that financial advisers are purely investment managers, whose only job is to select investments and achieve a certain level of return. Good financial advice however, goes way beyond this.

Advisers build and regularly update custom financial plans, conduct regular portfolio reviews, and also offer a range of ancillary services such as a tax-managed approach to investing, investment and cash flow analysis, retirement income planning, aged care advice and planning, Centrelink pension advice and one-off custom advice requests from clients.

Trusted Financial Planners and advisers, such as myself, are equipped with the necessary skills and qualifications to solve your financial problems or concerns.

A successful relationship with your trusted financial adviser requires engagement - on both sides - which is what we offer here at Holland & Holland.

People who engage with a Financial Planner and receive good quality advice are better off in the long run.

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