



THE SIX MOST IMPORTANT QUESTIONS TO ASK A FINANCIAL ADVISER

How to achieve the life you want by reducing the fees you pay on your investments, super and insurance.

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One of the best books I have read about personal finance is the *Latte Factor* by David Bach. A quote that is particularly influential on the way we work at Construct Wealth is:

“If you don’t know where you are headed, you might not like where you end up.”

Good financial advice should help you focus on what is important to you, on what you want to get out of life and ultimately give you a strategy to help you get there. Your personal goals should be the focal point for all future financial decisions.

People often come to us with investments, super or insurance that is not in their best interests. Often they have gone with the default options offered by their employer, sometimes they have taken advice off one of their friends or relatives, and occasionally they have taken advice off a financial adviser. The reason financial advisers put their clients into the wrong products is not because they are bad at their job, but because they work for companies who encourage them to only ‘sell’ their products. As a result, many people have investment products that have excessive fees or are paying too high a premium for their insurance.

To show the impact of setting things up correctly, we will use some recent clients as an example. They were a couple in their late 30’s, household income of around \$230,000, two young children, \$400,000 in the default investment option in an industry super fund. Our advice was to move to a different super fund and invest in a portfolio of index funds. As a result of the work they did with us, they have recently purchased their dream home; they have a clear plan for how to retire by the time they are 55; they have a dedicated travel budget; they will be saving more than \$500,000 in fees over the next 20 years; and their super is highly likely to perform in the top 25% of all investments.

This guide gives you the six questions you should ask a financial adviser, whether you are currently working with one or are looking to find one. These questions should help you

find out if the financial adviser is really there to do what is right for you without any conflict of interest.

If your adviser can answer yes to all six questions, it is likely they are one of the few truly independent financial advisers in Australia. Being an independent adviser means they are not tied to any of the products they recommend and they don't receive commissions or financial incentives for recommending investment or insurance products. Removing all conflicts of interest will mean they are best placed to put your best interests first.

Question 1

Are you independent under the law and if not, how come?

Good financial planning should be conducted in an environment free from bias. The best way to achieve this is to use a truly independent adviser. That is, they have no direct or indirect ownership links to any major institution or product provider, and they only charge a fee for the service they provide and do not take commissions.

If your financial adviser answers no to this question, ask them how they will guarantee their advice is in your best interest. Note, being independently owned is different from being an independent adviser.

Question 2

Do you give all sales commissions back to the client?

While commissions on investments have been banned, advisers can still accept commissions on personal insurance products. The most recent data suggests that 93% of advisers still take these commissions.

There are two issues with this. If your adviser gets a percentage of the insurance premiums, they may be reluctant to recommend you reduce your insurance. This can lead to people having too much insurance.

The second issue is that you end up paying higher premiums. While commissions are often said to be at no cost to the consumer, in reality insurers pass these costs onto you. The annual premiums you pay will be up to 30% more expensive if your adviser takes commissions. If your premiums are \$5,000, this means you are really paying the adviser \$1,500 a year, every year. The reason most advisers use to justify this is that when you need to claim they are available at no extra charge. What they do not tell you is how much you end up paying for this privilege. In most cases, you will be much better off paying an upfront fee when you take out your insurance. If you need to pay for future reviews and or assistance with claims, you will still be better off.

If your financial adviser answers no to this question, ask them to show you how much in additional premiums you are likely to be paying over the life of the policy.

Question 3

Are you or your employer free from financial links with any products you recommend?

Commissions on investment products have been banned. However, many advisory firms have in-house investment funds, which they recommend their clients invest in. These advisory firms do not have these as a charity.

There are two issues with in-house investment products. Firstly, companies make more money from their clients when they develop their own investment products. Many of these products not only have ongoing investment fees, but they may also have establishment fees and exit fees.

Secondly and probably more importantly, if you ever decide to sell the investment, it can generally only be sold to other clients of your advisers. There is a high risk that you will be locked into an underperforming investment.

If your adviser answers no to this question, ask them to explain how you will be better off, especially if they are in-house products. Ask them what the exit strategy is if you decide to sell.

Question 4

Do you usually recommend index funds and other low-fee investments?

There are broadly two types of investment funds. The first is the traditional actively managed funds where the fund manager invests on their member's behalf. The second are index funds (also known as Exchange Traded Funds) which simply invest in all companies that make up a particular index.

A research paper written by Vanguard shows that 75% of active fund managers do not beat the index they benchmark the fund against. I recently reviewed a client's investments and of the six managed funds they have, only one of them came close to the same returns from the index they benchmark themselves against. Most have been between 1% and 3% worse off every year for the last 10 years.

The reason for this is simple:

- Actively managed investment funds make up around 60% of total share ownership. If you put all these managed funds together, their average return is about the same as the market.
- Actively managed investment funds normally charge fees of between 1% and 3%. Considering the long term returns from the Australian stock market is around 6%, these fees are between 15% and 50% of your potential return.
- Investment fund managers find it difficult to regularly pick businesses that will outperform the market average.



Index funds have low fees and do not try and pick winners. They have fees of between 0.1% and 0.4% and as they track the index will perform in the top 25% of investment funds.

If your adviser answers no to this question, ask them to provide you the long-term benchmark returns of the investments they are recommending. Note that anything below 5 years is not considered long-term.

Question 5

Can you recommend any investments or do you have a limited list that you choose from?

Most advisers work for licensees that have their own Approved Product List (APL). These licensees argue that they have a team of people researching all of the available products to ensure they are the best for the clients. What they don't say is that:

- In some cases, the APL is limited to only their in-house products.
- In many cases the product manufacturers pay the licensee to have their managed fund or insurance product listed on their APL.
- In most cases the APL does not include the lowest-fee index funds or industry super funds.

If your adviser answers no to this question, ask them to explain the benefits to you and the fees you will be charged. If the fees are more than 0.5%, ask them why they don't have any low fee options.

Question 6

Will I be charged a flat fee regardless of how much wealth I accumulate?

Most advisers charge asset-based fees, which are a fee based on a percentage of the amount you have invested. If the market goes up by 20%, the fees you pay go up by 20%.

There are three things to be aware of.

- Advisers that charge asset-based fees have a conflict of interest and are tempted to put their interests ahead of yours. Let us look at a hypothetical scenario. You have a house with a mortgage of \$350,000 with \$300,000 sitting in an offset account. You go to see an adviser that charges 1% for assets under management.

Is this adviser more likely to recommend you keep that money in your offset account or invest it? Or put another way, is this adviser more likely to recommend a strategy where they lose the potential to make an additional \$3,000 a year or not?

- The second issue is the amount you are being charged, especially if you have more than \$1 million to be invested. If your adviser charges 1% in asset-based fees, for every

\$1 million you invest with them, you will be paying an additional \$10,000 a year on top of any other fees they charge you.

- Finally, imagine in a market like during the GFC or the COVID-19 crash where the value of some investments has fallen by 30% or more. This is the time you want your adviser to be thinking clearly. Is your adviser going to be in the best place to help you if they have just lost 30% of their revenue and are thinking about laying off staff?

If your adviser answers no to this question, ask them what additional work they will be doing if your investment portfolio increases by 20% or 50%. Ask them how paying these higher fees is in your best interest.

Conclusion

Financial advice is about more than just money, it is about making sure people are best placed to live the life they want. However, from a financial perspective, most people don't get the full benefit from financial advice due to the high fees they are paying.

To give you an idea of the fees, the Australian super industry takes around \$30 billion in fees per annum. While no-one expects people to work for nothing, there is no need for people to pay high fees for products that in most cases don't perform as well as some with lower fees.

As a guide:

- If your superannuation fund is charging you more than 0.5% in total administration and investment costs, then you are being overcharged.
- If your managed investment fund is charging you more than 0.3% in investment fees, you are being overcharged.

If you would like to make a booking for an obligation free discussion on how we could help you please complete the contact form at <https://constructwealth.com.au/contact-us/>

ABOUT THE AUTHOR



Phil Harvey is one of only 50 independent financial advisers accredited with the Profession of Independent Financial Advisers.

He started his journey to become an independent financial adviser in 2012 when he and his wife Fiona sought financial advice. They met with three financial advisers but couldn't get the advice they were after. They had an investment property and were putting money into super. All they wanted help with was making sure they had the right strategy to set themselves up for the future. The first adviser wanted them to sell their investment property and put their savings into a managed fund run by the adviser's employer. The second wanted them to buy another property and it just happened that the financial adviser was selling one that in their words would be ideal. The last wanted them to move from their low cost super fund into a fund run by their employer.

They quickly realised that the advice they received was aimed at selling them products, with very little attention paid to strategy.

Having a keen interest in finance and looking for a career change, Phil decided to start up a business that focused on providing strategic advice and helping people live their best life. In 2012 he went back to university and completed his Masters in Financial Planning. In 2018 Phil and Fiona launched Construct Wealth as a 100% independent and conflict free financial advice business. In 2019, Phil became one of only 50 founding members of the Profession of Independent Financial Advisers.

Phil is committed to helping as many people as possible set themselves up for the future. His approach is to help clients focus on what they want to get out of life and then shape a financial strategy around this.

Away from work, Phil enjoys the simple things in life, such as good food, a thriving garden (thanks to his agricultural science background), travel and helping his kids with their sporting endeavours.



This guide has been written by Phil Harvey for Construct Wealth. Phil Harvey is an independent financial adviser licensed through Independent Financial Advisers Australia (ABN 61601365904, AFLS 464629).

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