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A NEW DAWN

FPA MEMBERS VOTE ON THE FUTURE OF PROFESSIONALISM

Restoring the years the locusts devoured

One spinster's desperate search for tax guidance inadvertently helped rebuild the wealth she thought was permanently lost to bad advice. Mark Story explains.





Having had her fingers burnt twice before in dealings with two different financial advisers, Melbourne-based nurse Patty Knight (not her real name), 60, was beginning to think the best thing she could do with the remains of her accumulated wealth was shove it under the mattress.

While Knight is a self-confessed novice when it comes to financial matters, she had managed to accumulate a reasonable retirement nest egg before it started unravelling, courtesy of the wealth-destroying recommendations of previous advisers.

In addition to a debt-free family home, Knight also had a geared share portfolio, a \$250,000 investment property, an industry super fund and about \$30,000 in cash.

A decision 20 years earlier to back her first financial adviser's recommendation ended in tears. Knight was steered into the ill-fated Great Southern Plantations forestry investment and ended up joining a lengthy queue of creditors struggling to receive four cents for every dollar invested.

Ten years ago, with her experience of forestry investments a long forgotten nightmare, Knight mustered the courage to attend a financial seminar. She was looking to recover former losses and accelerate her wealth creation strategy.

Knight's newly appointed financial adviser convinced her to invest \$40,000 into each of two property funds within a self-managed super fund (SMSF) structure. To add further insult to her previous losses, one fund subsequently failed, leaving her with nothing, while the other was frozen. And at the current rate, these funds may take 10 years to be redeemed in full.

With retirement fast approaching, Knight was concerned that she may never sufficiently rebuild her nest egg - so she decided to start working extra shifts to help offset some of the losses. Unbeknown to Knight, her planner's recommended transfer of direct shares into a newly created SMSF threw up a \$10,000 liability in capital gains tax (CGT) and PAYG tax instalments that she could neither afford nor emotionally cope with.

CALL FOR GUIDANCE

With no immediate means of paying this debt, Knight knew it was time to get some help. Based on the recommendation of a neighbour, she approached financial adviser and tax specialist Daryl Forge three years ago, looking for tax guidance.

"When Patty first came to us she was not only distraught and confused at having lost half her wealth - courtesy of both bad financial advice and the GFC - but angry at having been left with such a hefty tax burden," says Forge. "Having accumulated wealth more by living frugally than investment stealth, her faith in financial advice had understandably been shaken."

While Knight's initial contact with Forge was for tax advice only, she says a thorough perusal of her tax position revealed the need for an immediate review of her overall financial position.

Knight was understandably anxious at the prospect of falling prey to yet another dodgy financial adviser. But having been suitably impressed by the quality of the underlying tax advice provided, she finally agreed to a full review of her entire investment portfolio in March 2009.

BETTER STRATEGY

Two key developments ensued, within short order. Firstly, Forge lodged a request with the Financial Ombudsman Service to investigate claims of professional negligence by Knight's former adviser. On the strength of those complaints, the former adviser was required to pay Knight an amount equal to the unexpected tax liability of \$10,000.

Secondly, Forge recommended that the \$230,000 of assets held by Knight within her SMSF account - including a significant basket of blue-chip shares - be sold and converted into cash and that the SMSF be immediately closed. According to Forge, the SMSF strategy was fatally flawed because it lacked the necessary breadth to provide the right level of diversification.

As well as placing extraneous demands on Knight as a trustee, Forge says her SMSF also lacked the critical mass needed to justify the

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Daryl Forge

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Forge established JDFA three years ago, together with tax specialist and partner Jennifer. Between the two of them they provide holistic financial planning services for predominantly mid- to high-net-worth Melbourne-based (and some interstate) clients. A qualified chartered accountant, prior to becoming a financial planner Forge spent nearly 20 years in the stockbroking industry, with the last three spent running NAB's online stockbroking division. His partner, Jennifer, has been in public practice as a Certified Practising Accountant (CPA), specialising in tax advice, since 2000, and also has a Diploma of Financial Planning.

Advice structure

Having been mindful of pending regulatory changes and their impact on future commission structures, Forge established the business under a fee-for-service model from day one. Charges are based on funds under advice, the complexity involved in developing and maintaining a client's wealth creation strategy, and the underlying risk.

History

Patty Knight initially crossed paths with Daryl and Jennifer Forge three years ago, following a referral from a neighbour who had been utilising their tax services. Knight's initial contact with the Forges followed two previous, equally destructive stints with financial advisers. Given the net loss position they'd collectively left her in, Knight's faith in financial advisers had fallen to an all-time low.

Strategy

Knight had been left severely out of pocket, due to some inappropriate financial advice provided by two former advisers. The anomalies associated with some unexpected PAYG tax issues - the initial reason for her contact with Forge - prompted Forge to question her prevailing investment strategy. Following an initial review, Forge discovered that the SMSF foundation on which Knight's portfolio had been constructed was not only costly, ill conceived, and unlikely to ever deliver stated returns - it forced her into investment and governance decisions she was not qualified to make. The SMSF needed to be wound up before a new wealth creation strategy could be developed and implemented. The first step to unravelling her problems was to deal with a totally unexpected and hefty tax bill that was causing her sleepless nights.

Financial summary

Assets	Nov 2007	Nov 2010
Cash	\$30,000	\$30,000
Gear Share Portfolio	\$34,000	\$97,000 (net of debt)
Residential Property	\$1.1M	\$1.4M
Investment Property	\$150,000	\$230,000 (net of debt)
Pension Fund	\$267,000	\$295,000
Super Fund	\$49,000	\$115,000
Total	\$1.630M	\$2.167M

fees involved in maintaining it. Based on Forge's recommendation, cash was invested into Dimensional funds via a Macquarie Wrap diversified platform, comprising three different fund managers, to provide conservative exposure to capital growth.

To ensure sufficient diversification across asset classes, the money was divided equally between Australian shares, international shares and investment grade cash assets. At Knight's request a smaller portion of direct shares was retained under her control to cover any unexpected future expenses.

ACCELERATING SUPER

Meantime, Forge also recommended that Knight make salary-sacrifice super contributions up to the maximum \$50,000 annually, leading to annual tax savings of around \$8,000. A transition to retirement (TTR) strategy initiated by Knight's former adviser remained intact.

Also based on Forge's advice, an additional \$40,000 in cash has been added to Knight's combined super/pension funds.

Undertaken initially as a trial run to see how much or little she could live on, Knight decided to take 10 per cent of her pension fund as an allocated pension to offset reduced salary from working fewer hours.

"I was pleasantly surprised how far a certain amount of money would go, and this helped to allay some of the fears about income into retirement," admits Knight.

With the Macquarie Wrap platform outperforming the S&P/ASX 200 benchmark, and the recovery of lost funds progressing slowly but surely, Forge says Knight is notably more relaxed about her financial position. In addition

'At Knight's request a smaller portion of direct shares was retained under her control'

to reducing her working hours, Forge has also convinced Knight to enjoy the fruits of her hard work - and she recently started to take overseas holidays.

RENEWED FREEDOM

Forge wanted to get Knight to the point where she had the freedom to decide whether she would retire fully or partially. If she decides to stay working, he says, it's because she wants to, not because she needs the income to live on.

"As to when to retire, Patty plans to spend the next six months working, go on holiday, then on her return decide what to do next," says Forge.

With the debt paid off on what was initially a geared share portfolio (using a margin loan), Forge recommended that Knight retain the outstanding debt on her investment property and use additional income from her fully franked dividends to service it. The plan is to hold off selling the investment property until Knight is finally retired to minimise any capital gains tax (CGT). But once she does retire, Forge says it's likely that she'll sell her remaining direct shares

to fund some lifestyle acquisitions, including future holidays and a new car.

LOOKING BACK

To Forge, the most pleasing outcome - especially given how much of Knight's super funds had been lost - is ensuring that she now has more than enough money for a comfortable retirement. That's especially reassuring, adds Knight, given that she comes from a family known for its longevity.

Knight was sufficiently impressed with her dealings with Forge's partner, Jennifer, on tax matters that she felt comfortable accepting his invitation for a complete no-strings-attached review of her financial situation. Her main priority was for Forge to sort out her super-oriented investment strategy and ensure she had sufficient funds to be able to stop working while she was still relatively young.

"My dealings with Daryl have restored my confidence in the value of independent financial advice," says Knight. "The recovery of lost money has also renewed my faith in 'checks and balances' within the system to weed out dishonest and incompetent practitioners."

With Knight being in a highly vulnerable state during those initial tax dealings, Forge decided not to charge fees up-front. And given that her scepticism of financial advisers remained high, he says it was important to gradually garner her trust.

"My decision to slowly recover the initial advice fee of \$3000 over three years recognised a commitment to working with Patty over the longer haul," says Forge. "I'm looking for clients who want 20-year relationships." ■