Article 2 - Introduction to the Financial Planning Sector and impending regulatory changes

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In addition to the real estate sector changing via national training requirements for qualification and licensing, the Financial Planning Sector is going through substantial evolution and change. The changes to this sector and the anticipated impact this will have in the Property sector and on direct property investors is substantial.

Financial Planning had the new Future of Financial Advice (FOFA) regulations passed into law and due to start on 1st July 2013. They enshrine:

- The clients' best interests test, requiring the financial planner to support the client's sustainable wealth creation goals
- The provision of partial advice
- Fee for services and
- The creation of a self directed client – someone who knows what they want.

Financial Planners were given a truly gargantuan initial regulatory load that required them to grow into three personalities overnight: one to meet and work with the clients; one to do the paper work; and a third to manage their professional accreditation and licensing requirements.

This change in the foundation of their business funding and their high professional indemnity insurance premiums will probably see the sector rationalised considerably. It is anticipated many will seek **easier business conditions** of sectors such as property investment. Remember **– the property sector is currently unregulated.**

A recent requirement for financial planning professional has given the three essentials as:

- There is an educational barrier to entry to practice – this is not a real estate qualification alone.
- That standardised business processes are backed by professional indemnity insurance
- National licensing and standards requirements have been updated

FOFA has taken this a step further with the **client's best interest's** definition supporting that it is good for the client and their goals.

This all sounds wonderful, BUT will it change anything in reality when it comes to how Financial Planners derive revenue from the property sector? Maybe and maybe not.

To explain, I recently contacted a Financial Planning firm (as I was informed they were looking for a Property Solution for their business), given the recent introduction of **client's best interest's** and the need to now consider direct property as part of a recommendation within a clients overall investment portfolio. Many financial planners aren't able to discuss direct property with their clients other than as an 'asset class' , so while they can suggest the client have an element of this asset class within their portfolio, their Dealers Licence doesn't authorise them to discuss it specifically as its not on their '*approved product list*' and *nor are they qualified* to do so. In short, they can't derive revenue from this product, with the exception of what many financial planners are now doing, which is to refer their clients to a friendly real estate agent, developer or project marketing firm and when their client buys a property, they receive a 'referral fee' (or commission) for the client introduction , which is received in a separate entity and outside of their financial planning firm. While the financial planner is **not** obliged to disclose this referral fee to their client, the reality is that by receiving money from the vendor of the property, they aren't actually acting in their **client's best interest's,** as they don't represent them in the transaction**.** By cleverly deriving their referral fees outside of their financial planning firm however, they aren't legally breaching their 'client's best interest's as its outside of the ASIC regulations, however one could argue morally that's exactly what they are doing.

Back to the financial planning firm that I contacted. Speaking with the MD, I brought up the subject of property and he informed me that his firm had just bought into a national real estate agency and that all of his nationally located planners would refer their clients to that agency, for their clients to buy property. When I asked him if he was providing his clients with a tailored property investment strategy, so that they would buy property specific to that strategy, his reply was that his clients " don't need one" ! Needless to say alarm bells went off. I asked why it was that his clients need a strategy for all the products he is authorised to sell, but not property given that it's a major asset class (the Australian property market was valued at $4.54 trillion in December 2011 whilst the stock market was valued at only $1.17 T) [1]. He replied again that he believed it wasn't warranted and they didn't need it. When I asked how that was in his **client's best interest's,** the conversation became somewhat strained and came to an end shortly thereafter.

The implications of this attitude and this type of property solution amongst some financial planners is quite substantial. Firstly, even if the firm discloses the commission that they earn or even rebates the client some of that referral fee, the money they receive comes from the vendor and they are still not operating in their **client's best interests.** Secondly, if their client at any point in time wanted to take legal action against the real estate agent, developer or project marketing firm, they would also be within their rights to take legal action against their financial planner as they have benefitted financially from the transaction and therefore have incurred a contingent liability, which their professional indemnity insurance won't cover.

Separate to that example, I spoke to another financial planner at a different firm and was pleased to find out that they were one of the rare firms whereby under their dealers licence, they were approved and qualified to discuss direct property with their clients and importantly, they built a property investment strategy into the clients Statement of Advice. They had access to a buyer advocate and a national database of new and off the plan property but what concerned me is that they developed their own property and therein lies a conflict of interest. It could be argued that selling their clients into their own development as a 'one size fits all' property solution isn't operating in their **client's best interests.**

Part of the problem lies with the Property Sector not being regulated, unlike the financial planning and mortgage broking sectors and part of the problem lies with the introduction of the fee for service model within the financial planning sector. Many planners now see themselves earning less money than they always have, hence the move to increase revenue by actively and sometimes aggressively referring their clients into property – without a tailored property investment strategy being in put in place for them (before they invest) and therefore, not morally acting in their **client's best interests.**

What investors need is suitably qualified and trusted professionals to give property investment advice that supports their wealth creation. A tailored property investment strategy, with sustainable investment entry, holding and exit strategies will offer risk mitigation so they can hold a property over their life time and realise the benefits as ‘retirement’ income.   This will support their successful and sustainable wealth creation.

What is vital that you take away from this is that you need to know the necessary questions to ask of your financial planner, to understand what is being presented to you, by whom and to understand who they represent and how they are renumerated in the transaction. From here, you will be better prepared to make informed decisions.

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