

Using software to better manage your practice through a market downturn

In this article, Matthew Esler, Midwinter's General Manager of Strategy and Technical Services highlights how financial planning software is available that can enhance new and existing revenue and steer your financial planning practice through the market downturn.

Background

With the Australian share market following the lead of most major international share markets in halving in value since 1 November 2007, financial advice practices around the country are beginning to feel the pinch (if they haven't felt it already). Irrespective of how your remuneration is structured – up-front, fee-for-service or commission-based – the simple fact is, the less wealth your clients have, the less money they have to pay for your services. For most financial planning practices, this has led to, or will inevitably lead to a fall in revenue.

Whenever a business experiences a squeeze in revenue, there tends to be two broad reactions:

- Expenses are reduced; and/or
- Activity is enhanced.

Whilst these reactions tend to occur mutually exclusively of each other – reducing expenses is seen as a defensive play, while enhancing activity is as an attacking play - good businesses usually implement the two simultaneously. So where does financial planning software fit into all of this?

Financial advice software should alleviate costs

Not only should financial planning software alleviate costs within a financial planning practice by virtue of making it more efficient and less reliant on manual research, modelling, paraplanning and administration, it should also drive activity. This includes assisting the financial planning practice in generating new business, but also through the development of opportunities organically.

Midwinter believes financial planning software in Australia has until recently been the domain of the monolithic system – the general multifunctional tool that can supposedly do everything, just not anything very well. These complex and cumbersome tools are inefficient and make up a significant share of most Australian financial planning practice's operating costs. We are constantly told by advisers that they are very expensive to purchase, are expensive to be trained in, are difficult to tailor specific to a practice's specific needs without further outlay, and are so difficult to navigate they are virtually not used by financial planners at all. They are used by administration staff and paraplanners who are IT-literate, but have little traditional financial planning experience – something that is sure to continue so long as they spend their entire day navigating around an unwieldy system trying to produce a single Statement of Advice (SOA).

Financial planners (and their paraplanners and support staff) should be utilising software which is simple and effective to operate, and reduces time. Time is the greatest cost to any business – save it and you not only save on cost but you put yourself in a position to use that time to generate revenue. Midwinter believes that the perfect example of the failure of incumbent financial planning software is in the time taken to produce advice. Investment Trends Planner Technology Reports of 2006, 2007 and 2008 highlight that despite significant technological advances over the past three years, the average time taken to produce a SOA has remained stagnant – 7.2 hours in 2008, 7.5 hours in 2007 and 7.6 hours in 2006. According to these reports, financial planners using Microsoft

Excel could generate SOAs quicker than two of the most commonly used applications. When it comes to product replacement advice – super to super, pension to pension switching and insurance comparisons (inside and outside super), in my experience, the average time taken to produce a SOA is closer to 16 hours.

At any time, but particularly during a market downturn, only financial advice software that assists the financial planning practice in reducing the time taken to produce advice and alleviates the financial adviser's burdens, should be utilised. The Investment Trends Planner Technology Report of 2007 asked financial advisers what the hardest part about being a financial adviser is – compliance/regulation was the most common response with 46% followed by administration/red tape with 24%. When financial advisers were asked "In which area could you save most time..." the most number of respondents, nearly 40%, answered SOA preparation. With new financial advice software now available that reduces the time taken to produce advice to less than half an hour, it is opportune time for financial planning practices to review their current software.

Financial advice software in Australia can be separated into three core components:

- Client Relationship Management (CRM);
- Portfolio Valuation/Management; and
- Advice Generation.

The incumbent generalist and multi-functional financial planning software are focussed on CRM and portfolio valuation aspects of financial planning rather than on the advice generation – which is the greatest time-lag for any financial advice practice. In Australia, despite this focus on the CRM and portfolio valuation modules, neither efficiency nor cost savings have been delivered to the end user. CRMs used by financial advisers in the United States can cost around US\$150-\$200 per adviser per annum. In Australia, some CRMs are sold to financial adviser dealer groups for \$1,500 - \$5,000 per annum per adviser. The good news is there are a number of CRM and portfolio management software manufacturers looking to make forays into the Australian market – so hopefully prices will come down soon.

Financial advice software should drive activity – new and existing business

Financial advice software should not only assist financial planning practices in bringing in new business, it should also empower advisers with the ability to grow their current book of clients organically. Organic growth of current clients is really a focus on maximising the available concessions and opportunities within tax, super, and social security during the accumulation, transition to retirement, retirement and death phases of a client's life cycle.

There are a number of organic growth opportunities that exist now that financial planners are not necessarily taking full advantage of because of the limitations of the financial advice software they currently utilise. These lost opportunities include:

- Optimising contributions to super for individuals and couples during the accumulation phase;
- Finding the optimal transition to retirement pension position to maximise retirement benefits;
- Maximising Age Pension entitlements – especially with the recent market downturn; and
- Implementing effective, compliant and appropriate gearing advice.

Optimising contributions during the accumulation phase

Most superannuation contribution strategy provided to clients during the accumulation phase is flawed. This is because it is usually based on the “top-down” accounting approach to tax strategy – i.e. salary sacrificing down to a certain assessable income level. This is sub-optimal contribution strategy and will not provide your clients with the highest level of retirement benefits possible for their given income levels. Optimal superannuation contribution strategy should be based on the “bottom-up” approach – that is, determine the client’s excess net income and use contribution optimisation software to work out the best mix of concessional and non-concessional contributions that provides the highest net contribution to super.

Finding the optimal transition to retirement pension position to maximise retirement benefits

Financial planners not currently implementing an optimised transition to retirement (TTR) strategy for preservation age clients who are still working, are missing out on the best wealth creation strategy available. Whilst most financial planners are now implementing a basic and often sub-optimal TTR strategy for their clients in transition phase, many are still not taking full advantage of all available concessions. An optimal TTR strategy can now be determined in a matter of seconds using the new breed of financial advice software. Financial planners should ensure that the software can determine the optimal pension drawdown and salary sacrifice position each year, enable Pension Refresh where the superannuation balance and residual TTR pension are commuted and rolled into a new TTR pension each year, and that the software enables the strategy to be modelled using the actual products being utilised.

Maximising Age Pension entitlements

The global financial crisis has no doubt had an adverse effect on all of your clients, but none more so than your retiree clients. With share markets taking a battering and interest rates falling dramatically, pensioners with no ability to make additional contributions to retirement savings are being forced into greater reliance on the Age Pension.

Those couples with over \$1,007,000 in total assessable assets prior to the share market collapse would not have been eligible for any Age Pension benefits. Even if they were conservatively invested they would now be most likely eligible for the Age Pension. For example – John and Mary are a home-owner couple and are both eligible for the Age Pension by age. As at 1 January 2008, John had \$600,000 and Mary has \$400,000 in an account based pensions (ABP) with \$50,000 in home contents. As a result are not eligible for any Age Pension under the assets test. They were both in balanced funds and by April 2009, they had fallen by 30%. John’s ABP is now \$420,000 and Mary’s ABP is valued at \$280,000. The couple would now be eligible for \$198.80 per fortnight in Age Pension benefits plus additional non-monetary benefits.

Implementing effective and appropriate gearing advice

The global financial crisis, the Storm Financial debacle and leveraged investment nightmares like ABC Learning, Centro Property, Allco Finance and Babcock & Brown have all contributed to making gearing a very bad word within the financial services industry. With Margin Lending advice about to fall under Chapter 7 of the Corporations Act – ensuring that the reasonable basis for advice rules under 945A and additional requirements under 947D be satisfied – the new focus should be on the provision of compliant gearing advice that is appropriate both in terms of loan to value ratios but also serviceability. Unfortunately, financial planners have not previously had access to software

which can effectively provide solutions to not only get clients out of geared positions, or provide comfort and security for those looking to gear their investments now.

For example – let’s say Peter, aged 45, had a \$400,000 share portfolio in June 2007. He decides to gear the investment using a margin loan at a “conservative” 50% LVR. He takes a margin loan out for \$400,000 against his current \$400,000 investment which has a maximum LVR of 70% with a 10% buffer. As at April 2009, Peter’s investment has fallen 40% to \$240,000. He is now in margin call – his actual LVR is now 83.33%. So what solutions can be provided to Peter to get him out of margin call and return him to his maximum allowable LVR of 70%. There are four options available:

- Add cash to reduce loan of \$64,000 (if he has a spare \$64,000 sitting around)
- Performance must increase by 19.05%
- Increase asset security by \$91,390; or
- Sell down asset security by \$213,290 and reduce loan.

Let’s now assume that Peter was not geared. His \$400,000 investment would still have fallen 40% to \$240,000 and now he is keen to gear this investment to take advantage of any potential upswing but is obviously concerned of the impact of further market falls. If we maintain the 50% LVR and take out a loan of \$240,000 the following security can be provided to the client regarding what needs to happen for him to be in a margin call position:

- Peter can remove cash from the loan of \$144,000 before margin call is triggered
- Performance needs to fall by a further 37.5%
- Peter can sell down asset security by \$179,990; or
- Increase the loan against the investment to \$1,199,710 (increase of \$719,710).

Conclusion

New financial advice software not only enables advisers to reduce their practice’s operating costs but will also make them significantly more efficient through advice generation and more effective use of their employee resources. Financial advice software should also be used to generate revenue – something that is hugely important considering the current state of investment markets and given the recent free-fall of financial planning practice revenue. The reality is that using incumbent monolithic financial planning software; advice practices are not taking full advantage of the concessions and opportunities available to their clients.

Contact Details

Midwinter Financial Services Pty Ltd
Level 11, 99 Elizabeth St
Sydney NSW 2000
www.midwinter.com.au
info@midwinter.com.au
Toll free 1300 882 938
ACN 121 020 620

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Justifying
your advice just
got a whole lot
easier with...

 *reasonable basis*