# Banks won't easily win over accountants

Opinion

Scott Charlton

The new wave of accountants set to enter the financial planning industry will be unlike any other group ever encountered before. Accountants are generally conservative and wary of institutions. Yet, the banks dominate financial planning.

Financial planners, insurance advisers and mortgage brokers have grown up working intimately with the banks and life insurance companies but accountants have had very little professional exposure to them. Having to potentially rely on an institution for licensing and support is an uncomfortable and foreign concept.

However, it's a very real possibility. From July 1, 2016, accountants must be licensed to provide non-product strategic financial advice and advice on the establishment of self-managed superannuation funds.

In the last few years, the institutions have developed licensing solutions specifically for accountants.

They're climbing over each other to help accountants navigate the government's new Future of Financial Advice regime because it's also an opportunity to beef up their adviser sales force.

The institutions see and treat advisers as a distribution network for their wealth management products. Accountants will be seen no different.

According to a survey by Roy Morgan Research, advisers who are aligned to the big banks channel more than two-thirds of clients' money into in-house products, with AMP advisers directing more than 80 per cent of inflows into AMP's super funds.

This inherent structural bias towards in-house product is at odds with the official motto of the Institute of Chartered Accountants, which is the Latin phrase "Nec timens nec vavens". That translates to: "Without fear or favour."

It will be a battle getting accountants to recommend in-house product.

Furthermore, there's a mismatch between the way financial planners and accountants are generally remunerated.

Advisers primarily charge percentage-based fees while accountants tend to charge an hourly rate or project-based fee.

For that reason, it'll be hard for accountants to support institutionally-owned platforms, which roughly charge between 0.5 per cent and 0.7 per cent of assets under administration. According to Investment Trends, 74 per cent of new money invested by financial advisers is placed via a platform, yet self-managed superannuation funds, and the accountants who advise the majority of them, prefer to bypass platforms and invest directly in shares, property and cash.

Accountants are the gatekeepers to the powerful SMSF sector. They are the trusted adviser to their clients.

They know their clients are increasingly fee-conscious with a strong desire for greater control, flexibility and transparency of their retirement savings.

They won't blindly herd their clients into expensive platforms, and because they're not tied to legacy products or influenced by how things have always been done, they're free to explore new, non-platform solutions, such as managed discretionary accounts and innovative investment solutions, such as the Australian

Accountants are positioning themselves to drop in on the financial advice industry. PHOTO: COLE BENNETTS

Securities Exchange's mFund Settlement Service. The ASX recently launched the mFund service, which allows investors and advisers to buy and sell unlisted managed funds using the underlying CHESS system.

This eliminates the need for paper-based applications and redemptions. It is a significantly lower-cost option than traditional platforms.

It's still early days for mFund but as more fund managers and brokers get on board, the service will become increasingly compelling.

Accountants are ideally placed to champion the next generation of flexible, transparent and cost-effective products and technological solutions.

While it's unclear how many accountants will choose to continue

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offering advice to their clients from July 1, 2016, what is clear is licensing alone won't ensure accountants and their clients are better off under the new regime.

An optimal solution will be one that also provides clarity and direction around an accountant's business model plus the tools and support to ensure they run a more productive, efficient and profitable practice.

Under the new framework, accountants can apply for a full or limited Australian Financial Services Licence (AFSL); join an institutionally-aligned or independently-owned AFSL; employ an experienced adviser to run their financial planning arm; or partner with an established advice business to outsource advice.

Those who join an institutionally-owned dealer group or partner with an aligned practice will also need to disclose, explain and reconcile any conflicts of interest with themselves and their clients.

*Scott Charlton is the head of Fortnum Professional Strategies.*

# At any rate, diversity is good

Jeremy Chunn

If advisers are nervously anticipating that a lift in interest rates will cause their clients' fixed-income portfolios suddenly to go thundering through the floor, they can calm down for just one moment.

"There is no pressure from an economic or an inflation perspective for the [Reserve Bank of Australia] to raise rates for an extended period," says PIMCO Australia managing director and head of portfolio management **Robert Mead**. If anything there is "a marginal bias" for the central bank to cut rates further, he says.

Prices of fixed-income investments generally drop when interest rates rise. The opposite holds when rates fall.

"As an Australian bond investor you've got to really look through the headlines and ask which markets are more exposed to higher rates and which markets are actually going to end up with lower rates," Mead says. "In a diversified portfolio, bonds make as much sense now as they ever have."

But Australians' retirement portfolios don't hold much in the way of bonds (see chart). We like shares.

Mead says a client's allocation to bonds depends on risk profile and age. As someone becomes more reliant on income the allocation to bonds should logically increase, he says, but those in the very early phase of accumulation could get by on as low as 15 or 20 per cent. Advisers are beginning to "get" bonds, Mead says, "but the one thing the broader investment community needs to get their head around is that yield doesn't necessarily equal return".

In an environment where interest rates remain low and yield curves remain relatively steep, a bond fund can deliver a much higher return than would be implied than by just looking at the yield, he says.

"If you look back to the crisis, you can see that every year the returns have been higher than the yields. That's the biggest learning curve, to educate around how bonds actually generate their income and total return."

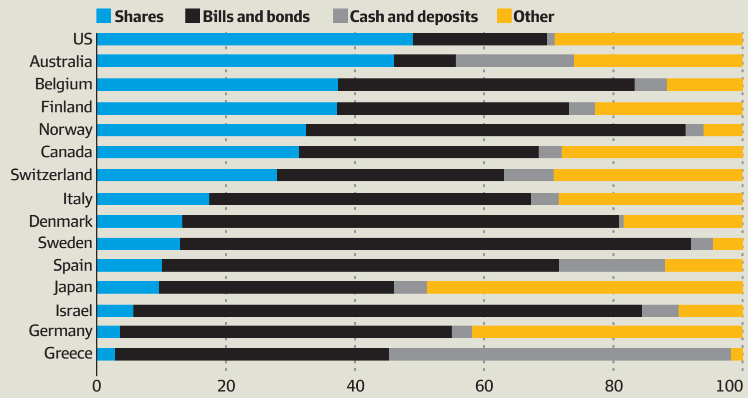
Bentham Asset Management managing director **Richard Quin** says calling the asset class fixed income is a great way of getting confused from the get-go. A lot of fixed-income investments make payments which go up and down with the money markets. In Australia, that may be the bank bill swap rate, at which banks lend to each other.

Quin's fund can hold all manner of assets where income is linked to floating rates, such as loans, corporate debt and asset-backed securities. When Asset caught up with Bentham it had hedged against a rise using derivatives.

Managers eke out gains in a bond portfolio by many means, including manipulating its duration. Instruments with a long way to go until maturity are

**Heavy on equities**

Pension fund asset allocation in selected OECD countries, 2012 (%)




SOURCE: OECD GLOBAL PENSION STATISTICS

**If you look back … you can see that every year the returns have been higher than the yields.**
Richard Quin,
Bentham Asset Management

vulnerable to movements in rates, whereas those closer to maturity are less affected.

"If interest rates rise it will hurt someone with a long duration," Quin says. "But if you 'short' duration and they rise it should make you money."

Rising rates reflects a stronger economic environment, so corporate credit spreads – the interest companies pay on loans – can be expected to increase. "That makes a lot of sense right now," Quin says.

Borrowers, including governments, have taken advantage of low rates and signed up for much longer-term loans. At the same time institutional investors have been trying to decrease the duration of their portfolios.

Bentham's modelled what a 1 percentage point lift in rates would do to its portfolio and expects an increase in returns, "which is unusual". The interest rate premium paid for floating rate notes at the short end of the yield curve will see values go up, he reckons, as credit spreads drop. "That's our strategy for this environment … but this is a very unusual environment."

Quin does not expect 2015 to be one where correlation between bonds and equities is negative, meaning that their values may rise or fall in tandem.

"Equities could be very correlated with bonds in a selloff, which means they both sell off," he says, predicting a 1994 scenario in which a rise in interest rates was bad for bonds and equities. "I think that's one of the things people have been understating." Floating rate instruments will be one of the few shock absorbers available to investors, if they happen to already hold them.

Exchange-traded funds of fixed income securities "tend to be more volatile [than a managed equivalent] and don't give you the same return, yet you're almost paying an active fee for them," he says. "They don't really make a lot of sense to us."

They make sense to investors, though, who tipped more into fixed income ETFs in October than any other listed index fund category. That had never happened before.

If it sounds like a good idea to wait until rates finally do rise and then try to assemble a bond portfolio from scratch as prices fall, Ardea Investment Management principal **Tamar Hamlyn** says it isn't that easy. "We would try to counsel people not to take the approach to hold on for the perfect entry point," he says. "History shows it's extraordinarily difficult. You might find yourself in a number of uncomfortable situations by taking that approach."

An investor could spend much longer on the sidelines than expected, which could turn out to be expensive. "As those costs add up and you're waiting month after month, year after year, and you don't get the outcome that you're looking for, before you know it those costs could turn out to be quite substantial."

The cumulative impact of an opportunity cost can be significant. Worse, you could move too early.

"Which ever way you look at it we don't think there's too much upside from trying to time things perfectly."

Instead, a slow transition to preferred allocations will minimise this "timing risk", which can be damaging to balances, and an insidious one.