Customers come first ... or do they?

JAMES KIRBY

So are we still to believe Australia has the best regulated banking system in the world?

Or is it time to amend that to something more accurate? In these still early days of the bank inquiry it might be more appropriate to say the banks as institutions are well regulated — that is, they are not at risk of falling over.

But when it comes to service, especially financial advice, customers have been a second order issue.

The spectacular and worse-than-expected revelations from the inquiry have prompted Scott Morrison to announce a major strengthening of penalties for both rogue companies and, crucially, for rogue executives who will now face up to 10 years in jail and up to $1 million in fines.

Even with a string of scandals already made public by a vigilant media, we could not have guessed that financial advisers in our major institutions routinely broke the rules, that they put themselves before the interests of their clients while the regulators played catch-up. (Usefully, investments regulator ASIC has been given greater powers to ban advisers in the federal Treasurer's announcement).

Meanwhile, as financial advisers look worse by the day, financial adviser groups are fighting among themselves about what level of qualification is appropriate — the Financial Adviser Standards and Ethics Authority, set up last year, is not moving at the pace expected and it's foundation CEO, Deen Sanders, has left the group after less than seven months in the job.

Bring on the higher penalties — they should at the very least act as a deterrent. Reform the amoral sales culture dotted across financial services and fix the fight over financial advisers qualifications immediately.

We can expect more executives of this era to disappear: AMP CEO Craig Meller is the first. We can expect banks to hive off wealth advice divisions. CBA's move to float Colonial will be copied by others.

But in the meantime millions of people need advice. They need to find a way to steer their fortunes through what has been revealed as a treacherous system. The image of a tearful Jacqueline McDowall, the nurse who lost her family home on advice from Westpac planner Krish Mahadevan, who is still employed by the bank, will stay with everyone in this business for a long time.

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As another era of reform looms over this perennially problematic system, how can you find a financial adviser who is trustworthy?

There are a range of questions you might ask an adviser but these are the top three:

•How are you paid?

Yes, commissions are supposed to be banned, but there are exceptions, for instance with insurance. We also know from the inquiry that FOFA (Future of Financial Advice) reforms have not been property implemented, particularly at the big banks. A planner should charge fee for service — on average it may work out at $1000 to $3000 a year.

If you want to ensure you don't pay more than you should for service, then do not accept "percentage arrangements" where the cost is linked to the size of your investment portfolio.

•Are you linked or tied to any other institution?

Independent advisers are much less likely to be corrupted by links to a major institution. Yet the reality is rarely simple. Some of the best planners are linked with institution including several in the upper reaches of *The Australian*'s Top 50 advisers list.

•What are your qualifications?

This is a quagmire. The commonly held RG146 qualifications are clearly not good enough. The CFP (Certified Financial Planner) certification is regarded as the top qualification. But then again, as a reader of these pages pointed out this week, ethics and qualifications have no correlation.

Put simply, the standards, the procedures and qualifications in this area are poor. The inquiry recommendations may ultimately advocate a wider clean-up. In the meantime you are on your own out there. Asking the right questions is the first step towards protecting yourself and finding an adviser you can trust.

Clean, green? Frankly it's your moment

MY WAY

three lines of standfirst in here please

RICHARD FERGUSON

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AARON FRANCIS

There's a royal commission into banking in Australia. Why should investors think sustainable investment funds are any better than the likes of major banks or insurers?

We invest in a sustainable fund so it's no surprise we want to be best boy scout. Generally, you would expect sustainable investment to be more conscientious. The smaller the provider, the more likely they are to be authentic. It tends to be the bigger fund houses that "green wash" products and they may have fee problems too.

There was a recent study in the US which shows sustainable investment goes up under Republican presidents and down under Democrats. Is it just a conscience vote?

There is still a perception that sustainable investing is a conscience vote, but it's changing. My parents even struggled with the idea. My father said that you are separate from your money. But I think younger generations believe that money is an extension of you. If you wouldn't work for a tobacco company, why would you put your capital there?

So what is sustainable investing?

It is investing in companies where what they make actually answers a sustainability challenge. For example, Pengana invests in insulation companies, we invest in train companies because trains are more environmentally friendly than cars.

There's been a big mood shift from divestment to impact investment in social and environmental issues. Why is that?

People realised that the negative ethical screen approach was not working alone. Not investing in tobacco, firearms, pornography etc still leaves a whole pile of issues that people want solved. And active investment saw a financial opportunity there as regulation and the culture changes. Divesting fossil fuel companies is a bigger deal because you can make change by selling those guys — so divestment isn't dead.

Sustainable investment might help the planet, but does it make you money?

Certainly, I can say if you've invested in traditional fossil fuels, mining and extraction, or non-sustainable utilities in the past decade and a half, you'll have had a difficult time. There is plenty of opportunity to invest sustainably and get good financial outcomes and no penalty at all.

So what's the skill and how do you do it?

We see five environmental pots of opportunity: cleaner energy, resource efficiency, transport, environmental services such as recycling companies and water management. And then there are the social pots: education, health, wellbeing and safety. Investors can also look at biodiversity and sustainability in terms of financial inclusion, social property.

How do you decide what you include and what you exclude in this fund?

As I mentioned you've got to make a product — or provide a service — that solves a sustainability challenge. And you have to ensure that the solution is enough of an improvement on what's previously been done. We also have to believe that sustainability is enough of your business for us to say credibly this business is creating positive change.

How did you get into sustainable investment?

My father was in a development company and we travelled around the world a lot. And you couldn't help but notice the huge inequality in developing countries. I wanted to make a difference. I trained up as an accountant and worked with renewable companies. And I've been with Pengana since my early 20s (I'm now 38) and I've never looked back.

What was one of Pengana's first big successes?

A Swedish company called Neba was a lot of fun. It makes heat pumps, which are a very efficient source of heat, and they had very high environmental standards — even more interesting because they deal with very dangerous chemicals. When we called them, they were so surprised. We were the first non-Swedish investor to ever call them (laughs).

And what was your first big investment personally?

The first time I got a meaningful lump of money, I was sitting in the middle of the financial crisis. I did a straightforward thing — I put that lump in a FTSE tracker at 3600 points. It wasn't sustainable, my ideas weren't that advanced, but all I could see was a time of panic and I sold it at 7000 points.

What are your personal investments?

My investments are all in the fund. I'm the fund manager. So to this point about transparency and fees and the royal commission; I don't have any investments other than the fund. It's all I do.

You own your home?

Well, yes. My biggest investment is a massive leveraged bet on property like anyone else who lives in London (laughs). If I had the choice about how much wealth I have in my home vs the rest, it would not be the blend I currently have.

Q My husband and I have just rewritten our wills. Our solicitor has instructed us to ensure we nominate each other as beneficiaries under our superannuation funds and that they be binding death benefit nominations. Shouldn't our wills cover our instructions on death and why does it need to be a binding nomination?

A Your will is a legal document that sets out your wishes for the distribution of your estate assets on your death.

Assets owned jointly as joint tenants are not covered by your will as ownership will revert to the surviving owner on your death. Your share of assets owned as tenants in common with other parties do form part of your estate and are dealt with via your will. Assets held in trust on your behalf are generally not dealt with under your will, but are governed by the terms of the applicable trust deed.

Superannuation is an example of an asset held in trust on your behalf. As the trustee owns the assets on your behalf, the legal mechanism to instruct the trustee on how to distribute the proceeds of your superannuation on your death is called a death benefit nomination.

A superannuation lump sum death benefit can be paid only to an eligible beneficiary or be specified to be paid to your estate/legal personal representative as the death benefit nomination.

An eligible beneficiary must be a spouse, your child, an individual financially dependent upon you, or an individual with whom you have an interdependency relationship, which is a close personal relationship, where you live together, and one or each of you provide financial support and domestic support and personal care.

There are two types of death benefit nominations: binding and non-binding. A non-binding nomination is not binding on the trustee of the super fund to pay out the funds to your specified beneficiary. In some circumstances, a superannuation trustee may allocate a portion of your superannuation benefit to an individual regardless of your nomination, provided they meet the definition of a beneficiary.

A valid binding nomination compels the trustee to pay the death benefit to the eligible nominated beneficiary.

A binding nomination can be non-lapsing, where the nomination will never expire; or it can be lapsing, where the nomination expires every three years.

A binding nomination must be signed in the presence of two witnesses over 18 and who are not nominated as a beneficiaries.

Presumably your solicitor has recommended binding death benefit nominations for your superannuation funds to ensure the proceeds are paid out to the surviving spouse without the risk of the trustee executing discretion to provide a benefit to other potential claimants.

As the claim does not form part of your estate, (unless the estate was specified as the death benefit nomination) the death benefit would not be tied up with the conventional process of settling the estate, and the delays associated with a grant of probate.

Most of your net worth and who receives the benefit may be determined by your superannuation death benefit nomination.

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Retirement village players widen fee options

JOHN RAWLINGS

In what may turn out to be a major change in how we pay for retirement home care, the nation's biggest retirement home operators are introducing new payment options for management fees. This may mean more choice for consumers, but the changes will doubtless further complicate an already byzantine industry.

Aveo, one of the large players in the retirement village market, already provides potential residents with nearly 200 pages of paperwork to plough through when considering to move into one of its villages, including a residence and management contract (56 pages), a personal services agreement (40 pages), a licence deed (46 pages), a user-pays personal services agreement (12 pages), a disclosure statement (10 pages), a fact sheet (10 pages) and a loan agreement (eight pages).

Lendlease plonks a 48-page residence and management contract in front of all potential residents, in addition to a fact sheet and disclosure statement.

Now Lendlease is offering three new payment options for residents to pay management fees — a prepaid plan, a refundable contribution option or a pay-as-you-go scheme. Another retirement village giant, Stockland, is introducing its own alternative payment option, while Aveo is attempting to simplify its payment methods.

Aveo, Lendlease and Stockland are the three major players, but ownership in the retirement village sector is widespread, with the top five operators controlling only 28 per cent of the market. The balance is controlled by community and church-run not-for-profit operators and smaller owner-operators.

Lendlease has announced it will still offer its standard contract. Residents can pay to live in a retirement village, and when they leave they receive the sale price less a deferred management fee (up to 35 per cent of the sale price) and less any reinstatement fees and selling costs.

> New fee options may mean more choice for consumers, but will doubtless further complicate an already byzantine industry

Lendlease's new prepaid plan gives residents the option of paying management fees upfront (around 18 per cent of the cost of the unit), but then receive all capital gains upon leaving, less reinstatement fees and selling costs.

Under the refundable contribution option, management fees are refunded in full within two months of the resident leaving the village, less a non-refundable establishment fee of 3 per cent, charged upfront.

The pay-as-you-go option — only available on serviced apartments — allows a resident to pay a monthly charge and a security deposit equal to two years' worth of rent. The security deposit is refunded within two months of a resident leaving, less an establishment fee equal to three months' rent.

Retirement village operators have been under pressure since last year's media exposure on Aveo by ABC's *Four Corners* which uncovered a raft of questionable practices. Following this, several state governments announced inquiries into the sector. The results to date have been mixed. In Queensland, legislation was introduced to help safeguard the rights of potential residents.

Depending on who you are dealing with, people generally have four types of agreements to choose from when trying to select a retirement village: a long-term lease/licence, a strata title, a company title scheme, or a rental agreement.

When you commence discussions with a village operator, they are required to provide you with five pieces of information: a copy of the residence contract, a copy of the management contract, the disclosure statement, the village fact sheet, and the village rules and by-laws.

Lendlease says the three new options offered are meeting the demands of potential residents for more choice and greater certainty.

Doubtless more choice will lead to more confusion. A potential resident will now need to be able to compare the financial outcomes of each option and determine what is the best one to meet their needs. Management contracts are already long, complex and difficult to understand if you are not a lawyer.

Ultimately residents must keep in mind that, when they are entering a retirement village, they are making a lifestyle decision and not a financial investment. There will surely be new residents who will be able to benefit from Lendlease's proposed new options. It just may be difficult to be sure whether you are one of them.

John Rawling is an aged-care consultant at Joseph Palmer & Sons.

Speed bumps ahead for Kogan, a2 Milk

ROGER MONTGOMERY

Once again, as some investors leave the party, even as the band keeps playing, many are only beginning to wonder whether stocks can fall. Indeed, in recent days a record $US34 billion ($44bn) flowed into equity index exchange traded funds.

And when it comes to equities, be certain of this: there are market darlings today whose share prices will decline 50, 60, 70 and even 90 per cent in the next 12-24 months. The argument for a reversal of financial conditions is not only becoming more plausible. It's actually now visible. And be sure to zip up your wallet if someone suggests that because Australia's stockmarket didn't rise as much as the US, it won't fall as far. That kind of nonsense has no place in a world where correlations increase as markets dislocate — the baby always gets thrown out with the bathwater.

Speed bumps are emerging for highly prized companies, questioning earnings multiples that can only be justified by high double-digit profit growth rates.

When e-retailer Kogan (KGN) announced a few days ago it will offer pet insurance, its shares shot up 14 per cent. The market also reacted positively to Kogan's announcement it will start selling fixed-line NBN broadband connections, partnering with Vodafone. The fact is it is entering an industry where larger, more established players such as Telstra (share price down 31 per cent from one-year highs), Vocus (down 44 per cent) and TPG (down 20 per cent) are suffering from intense and arguably irrational competition and declining margins.

And on Amazon's intention to launch in Australia, in direct competition with smaller players, Kogan told News.com.au: "We're excited by Amazon's launch, anything that can be done in Australia to bring more significance to our online retail industry to make more people aware of it, the better." Shortly after the comments, Kogan's founder announced he had sold $50 million of shares in the company he founded.

Similar, and arguably misplaced, optimism is evident in the market for infant formula. Listed distributor a2 Milk (A2M) has seen its shares soar more than 700 per cent in little more than two years amid optimism about sales success in China. On March 28, 2018 Nestle, the world's biggest food and beverage company, announced the launch in China of an infant formula that uses the A2 beta-casein protein made popular by the a2 Milk Company. A2 Milk's response to the entry of a super competitor is almost identical to Kogan's: "(We) consider that new entrants should assist in building credibility and awareness for the A1 protein-free proposition, and hence build the overall category more quickly."

How can it be that more competition, especially from global giants, is universally good for everyone? Wake up! Ask Myer what happens when Amazon, Zara and Uniqlo turn up to compete. Equity investors are still flirting with market highs and pumping record amounts of money into ETFs undaunted by the prospect of Amazon hurting Kogan's plans or Nestle disrupting a2 Milk's. But globally, corporate bond investors are evacuating the scene. The Bank of America Merill Lynch BBB bond spread has widened to its highest level in six months and yields are near the highest levels seen since 2012.

The recent equity bull market can be characterised by a concentration of investment flows into a narrow band of concept stocks. The prices of these stocks imply uninterrupted earnings growth of 30-40 per cent a year for the next decade. Such growth paths transpire much less frequently than the preponderance of companies whose share prices reflect such hopes. It's time for investors to be very, very careful.

With the cost of private debt now rising (3 month US Dollar LIBOR interest rates have risen almost fourfold from 0.61 per cent in January 2016 to 2.29 per cent now), even in the absence of central bank intervention, investors are being surprised to discover that emerging doubt about the prospects for earnings growth can manifest itself in lower price-to-earnings multiples.

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