

Books like this can be hit or miss. In many ways, the 'how-to style of 'rulebooks' can be a major limitation to the extent that they work at all. The contents of the books tend to apply only to a very narrow band of reader – for example, people with sufficient equity in their own home and who live within stoking distance of cash flow positive properties (where is the suburb named 'Cash Flow Positive, again?). This book does not suffer from this limitation. In many ways, this is because there are so many rules (there are 100) that they cover a wide range of bases. Secondly, the rules are not too precise. They are, for the most part, general attitudes towards money and wealth that are not so detailed as to be only narrowly applicable. Each rule is stated as and then followed up by a two or three page discussion, which is on the point of the rule.

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DOVER



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## The Dover Guide To The Financial Planning Process

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## **The Dover Guide to the Financial Planning Process**

### **Introduction**

The financial planning process is a complex and continuous series of steps, with continual feedback loops, designed to ensure your clients receive the best possible advice regarding their financial planning profile, including specific product advice, estate planning, superannuation, asset protection, taxation planning and lifestyle and retirement management.

Dover advisors follow a systematic process to ensure their client's statements of advice, or financial plans, are effective and efficient, and 100% compliant with the Corporations Act and related legislation. This system also means Dover advisors stand out from the pack, with their statements of advice displaying a technical edge and creativity suitable to each client and making sure each client receives the best possible advice and service, surpassing industry norms and standards.

This guide focuses on the steps to be taken by advisors up to the preparation of a detailed financial plan, or statement of advice and provides guidance and suggestions on how to get the most out of this process to make sure clients' statements of advice are as effective as possible and all compliance requirements are satisfied.

The preparation of an effective statement of advice is detailed in the Dover Guide to Preparing an Effective Statement of Advice, which can be downloaded on the [www.dover.com.au](http://www.dover.com.au) website.

### **A reasonable basis for your advice**

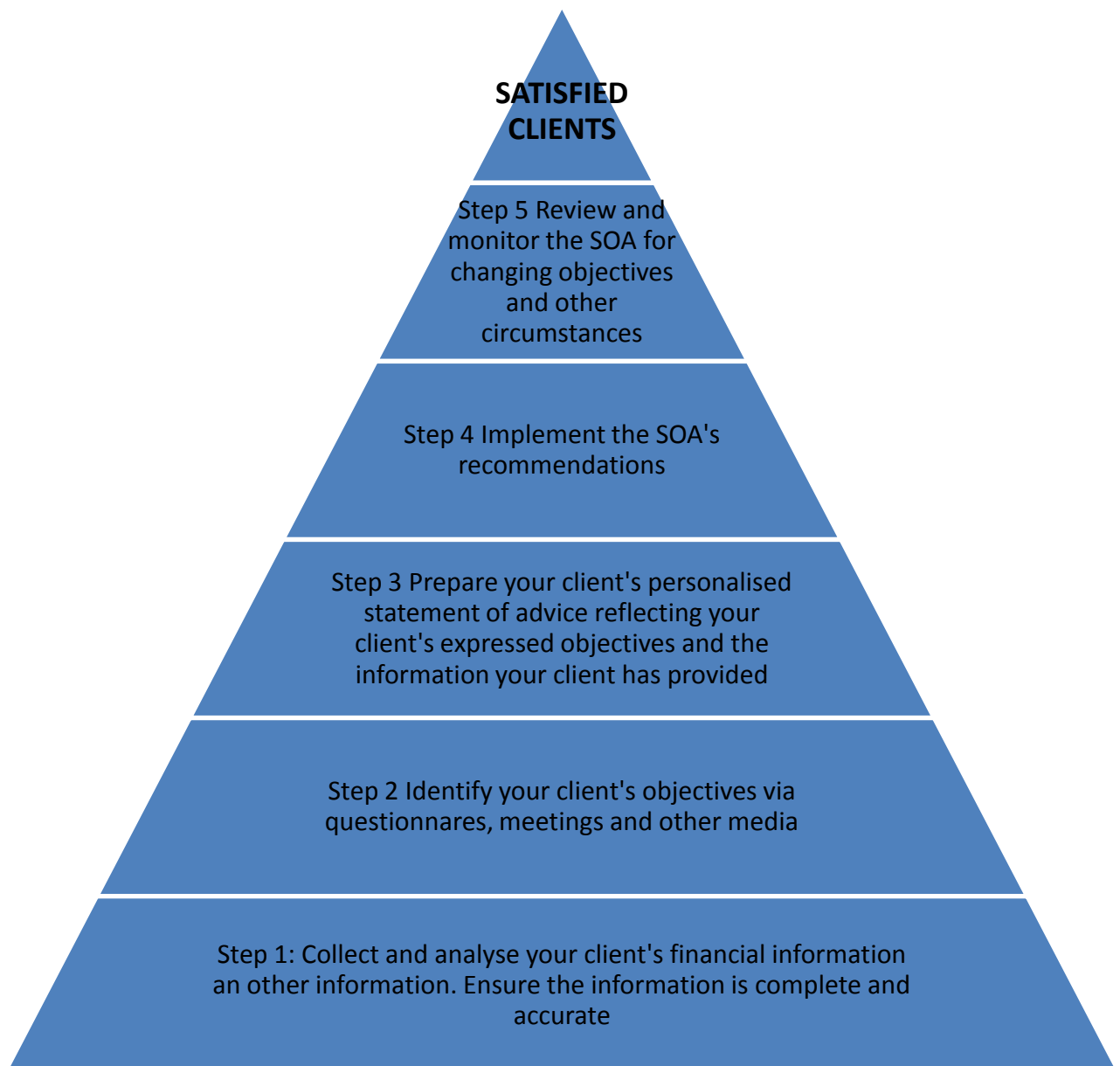
Advisors must be able to show that they have obtained all necessary and relevant information relating to a client before providing any financial product advice.

Advisors must provide advice that is specific to the client and suits their circumstances if they are to comply with the Corporations Law rules for financial planning.

### **A five steps approach to financial planning**

Conventional financial planning theory posits a five step financial planning process to take each client through the journey of developing a competent financial plan.

The five steps build on each other and may be depicted as a pyramid, with each step building on its predecessors.



**Step 1 Collect and analyse client data**

**Step 2 Identify client objectives**

It's arguably artificial, if educationally useful, to separate out steps 1 and 2. In the real world they merge together, occurring almost simultaneously, and with continual formal and informal loopbacks to allow the financial planner to prepare to put pen to paper in a final series of written recommendations contained in the formal financial plan, or "statement of advice" as it is called in the Corporations Law.

The collection and analyse of your client's information is the critical first step in the client advice process. It's critical because if the information is not complete and accurate then everything built on it will be flawed.

Information will normally be collected and analysed in a formal meeting, but will also be contained in telephone discussions, fact finders, risk analysis questionnaires, e-mails and letters, original documents such as tax returns and wills, previous financial plans and other media.

Information will focus on the financial, but will also include, and non-financial information such as age, marital status, work and lifestyle balance issues, concerns about relatives, career and family aspiration, personal philosophies and ethical viewpoints and other personal criteria.

Advisors need to be empathetic with clients, to overcome an understandable reluctance to divulge personal information, and also need to compare this information with other information and filter it to identify exaggeration, incompleteness or bias.

First impressions count and your general demeanour and presentation at the information collection phase will go a long way to ensuring a successful financial planning experience for both you and your client.

You should bear in mind that section 945A of the Corporations Law requires you to have a reasonable basis for your recommendations, and knowing your client is an essential prerequisite. Further, section 945B requires you to warn your clients in your SOA if you believe your advice is based on incomplete or inaccurate information.

ASIC's Regulatory Guideline 175 Licensing: Financial product advisors- conduct and disclosure builds on section 945 and stresses the need for advice to be reasonable and suited to the client, or if you like "fit for its purpose"

Good verbal communications, a professional interview technique and a confident and personable manner are essential personal skills for meeting these standards.

### **Your financial services guide**

Your financial services guide should be provided to your client as soon as part 1 of the financial planning process starts.

Your financial services guide will set out all necessary information including how you are paid and what happens if your client has a complaint about your services.

### **Fact finder and other data collection tools**

Good practice requires a formal data collection tool to be created for all clients and up-dated on a regular basis. This data collection tool should be designed with external audit by Dover and, ultimately, ASIC, well in mind. The records should show that the representative has been detailed, thorough and complete in collecting and collating relevant documents.

A fact finder should include:

- contact details;
- personal details such as age, marriage status, family relations, health and so on;
- income details;
- current wealth details;

- the composition of debt;
- superannuation details;
- estate planning details;
- retirement plans and expectations; and
- any matters the client wishes to specifically discuss.

**Risk profiling**

Risk profiling is the process of measuring and identifying a client’s attitude to risk, particularly the concept of downside risk, that is, the possibility or probability of an investment earning less than its expected rate of return. Financial planning theory accepts that there is an inverse relationship between risk and return and that generally speaking higher expected returns bring with them higher expected risk.

Risk profiling is a notoriously difficult area, and a finite discussion is beyond the scope of this guide.

Dover takes the view that all clients should be assumed to be “reasonably conservative” and risk averse, unless three conditions are met, being:

1. the client positively claim to be less risk averse than average, or even a risk seeker (ie a subjective test);
2. there are objective facts which support this claim (ie an objective test); and
3. the claim is reasonable and in line with established professional standards and experiences (ie a reasonableness test).

For example, a thirty five year old profession with a university education, wealthy parents, no dependants and a successful background in share investing may be assessed as being less risk averse than normal and more suited to high growth assets and high (deductible) debt levels. This client passes each of the subjective test, the objective test and the reasonableness test. On the other hand, a fifty five year old retiree, of modest means, and a low level of financial literacy should be classified as a conservative investor. This is the case even if they claim otherwise: the may pass the subjective test, but they fail the objective test and the reasonableness test.

Obviously there will be significant differences in the statement of advice prepared for each client.

Client attitude to risk are generally classified as follows:

<b>Classification</b>	<b>Probable investment mix</b>	<b>Probable debt percentage</b>
Very conservative	High cash component Low growth component	None
Reasonably conservative	Cash component between 50% and 70% Growth component between 50% and 30% High degree of diversification	No more than 20% on growth assets, including indirect gearing
Average	Cash component between 50% and 30%	No more than 40% gearing on growth assets, including indirect gearing

	Growth component between 50% and 70% Reasonable degree of diversification	
Growth investor	Cash component between 30% and 10% Growth component between 70% and 90% Lower level of diversification	No more than 50% gearing on growth assets, including indirect gearing
Aggressive growth investor	Up to 100% in growth assets Low level of diversification	Up to 60% gearing on growth assets, including indirect gearing

Client attitude to risk will change over time, and may change quickly due to changed personal circumstances (example: the loss of employment) or changed macro-economic circumstances, (example: rising interest rates). It is critical that all clients, particularly growth investors, are monitored and reviewed on a continuous basis and that the advisor is aware of the possibility of investment preferences and attitudes to risk changing.

A good rule of thumb is the “can you sleep at night test”. If a client is worried or concerned, and if you like “cannot sleep at night” then it is a good sign that the recommendation is outside of their risk profile and should not be implemented.

Generally, advisors should adopt a conservative approach and should not recommend gearing or borrowing to acquire growth assets unless the risks have been clearly and unambiguously explained to clients in writing with appropriate warnings, and the clients has consented in writing to this.

### **Risk analysis studies**

Fina Metrica Pty Ltd is one firm providing research into risk analysis and its co-founders Geoff Davey and Paul Resnik have prepared a paper entitled “Risk Tolerance, Risk Profiling and the Financial Planning Process”.

The paper studies advisor attitudes to risk tolerance questionnaires and the role these tools have in the financial planning process, and their predictive capabilities and their inherent limitations in behavioural psychology.

Some things we know about risk tolerance include:

- (i) risk tolerance is normally distributed and standard statistical techniques can be applied;
- (ii) males are more risk tolerant than females;
- (iii) risk tolerance increases with age;
- (iv) risk tolerance appears to increase with income, wealth and education;
- (v) risk tolerance appears to decrease with marriage and the number of dependants a client;
- (vi) international studies are applicable to Australia; and
- (vii) financial advisors tend to be more risk tolerant than the average investor (which is a word of caution about imposing your own views on what a client should or should not do).

Sometimes clients need to take more risk than they think they do if they are to meet their financial goals, and this may create a need to reduce goals or educate about risk if the client's objectives are to be met, within their risk preferences.

Finametric Pty Ltd identifies three risk related issues in portfolio creation. These are:

- (i) the client's "risk tolerance";
- (ii) the risk required to achieve the client's financial objectives, ie "risk required"; and
- (iii) the "crystallised risk" a client could accept without changing their financial objectives, ie "risk capacity".

Examples are created to explain how these concepts influence the creation of a statement of advice or financial plan. The paper concludes:

*"A psychometric assessment of risk tolerance provided a firm, plain-English foundation for exploring options with a client. It underwrites a transparent process that leads to the optimal (based on the client's values) strategies for the client. It is an essential ingredient in a financial planning process that leads to the client's properly informed commitment to both the plan and the portfolio."*

You can download this paper at [www.riskprofiling.com](http://www.riskprofiling.com) or here: [Risk Tolerance, Risk profiling and the Financial Planning Process](#).

### **The know your client rule, and the duty of utmost good faith, or**

These examples and explanations highlight the importance of knowing your client.

Advisors must remember the words of Smith J in the Hartley Poyton case where he explained that a financial advisor owes a fiduciary duty, ie a duty of utmost good faith to his or her clients:

*It has been held that such a relationship between stockbroker and client demands "high standards of integrity". The stock broker acts "not for himself but for his client". It has also been said that clients "entitled to expect from a broker not only competence but also integrity and the absence of conflicting personal interests. His position is one of trust and responsibility. (Paragrah 266)*

### **Step 3 Prepare your client's statement of advice or financial plan**

This is a the major task that presents to you and it is discussed in detail in the Dover Guide to Preparing an Effective Statement of Advice, which can be downloaded from the Dover website.

### **Step 4 Implement the SOA's recommendations**

The statement of advice should clearly set out who is responsible for implementing the SOA's recommendations. As far as possible the responsibility for implementation should lie directly or indirectly with the advisor.

Some recommendations will need to be implemented by the client. For example, advice regarding reducing working hours in anticipation of starting a transition to retirement pension is something only a client can do. It's up to the client, and possibly the client's partner and family, to take the steps necessary to reduce his or her working hours.

Some recommendations will need to be implemented by another advisor. For example, a recommendation to execute fresh wills creating testamentary trusts can only be completed by a solicitor. However, the advisor should be responsible for making sure the wills are prepared and signed even to the extent of delivering the completed wills to the client and making sure they are signed and witnessed properly.

Many recommendations will be implemented directly by the advisor, such as arranging the placement of a financial product such as a managed fund or a term insurance policy.

Implementation should be actively monitored as ultimately the advisor is responsible for making sure things go to plan.

“Authority to proceed” documents should be signed and placed on the client file as a record and proof of the advisor’s authority to act on the client’s behalf.

### **Step 5 Review and monitor the SOA for changing objectives and other circumstances**

The final step in the financial planning process commences almost as soon as the SOA recommendations have been implemented, if not earlier.

Good practice requires the advisor to constantly review and monitor the SOA for changing objectives and other circumstances. These include:

- (i) underlying performance of recommended financial products;
- (ii) continuing suitability and likely future performance of recommended financial products;
- (iii) the client’s changing financial position, including income level and wealth level;
- (iv) the client’s changing attitude to risk;
- (v) changing legislative environment; and
- (vi) changing economic conditions.

These present opportunities for advisors to build better relationships with their clients.

The simplest and easiest way to review and monitor the SOA is to arrange regular review meetings, say once every six months, and to create a newsletter, blog or similar service where the advisor provides general advice (identified as such) to keep clients generally aware of changing circumstances and the need for regular meetings and one-off meetings if a specific change occurs.

Good practice requires regular invitations to meet to discuss any matters of concern.

### **A never ending cycle**

Step 5, being the review and monitoring process naturally leads back into steps 1 and 2, being the collection of client data, and so the financial planning cycle continues.



