

the fold

WHY PORTFOLIO MONITORING IS IMPORTANT AND WHAT TO DO ABOUT IT.

Ongoing monitoring of clients' investments is likely to be the subject of increased scrutiny going forward – by both clients and regulators.

The regulator - and that new form of quasi-regulator, the financial press - has historically been focused on the appropriateness of the financial products recommended by advisers. But ongoing monitoring of clients' investments is one of the most important (and enduring) services that financial advisers provide.

There are early indications of a new focus on advisers' ongoing service obligations - in particular their obligations to monitor and manage clients' investment portfolios.

A new focus on advisers' ongoing service obligations.

WHAT ARE THESE INDICATORS?

Increased scrutiny of advisers' contractual obligations.

Any analysis of the post- GFC Financial Ombudsman Service's determinations which considered financial advisers' obligations to monitor their clients' investments shows that advisers who have contracted to provide ongoing services to their clients have quite extensive obligations.

FOS's archives abound with successful complaints against advisers who failed to warn clients about underperformance in their portfolios. These determinations make it clear that advisers who offer to provide an ongoing monitoring service will be liable for any losses the client suffers as a result of a failure to do so.

Advisers need to describe their ongoing service offerings carefully; ensuring they clearly define the nature and extent of the monitoring they are

committing to undertake. If advisers only want to review client's portfolios, say quarterly, their ongoing service agreements need to make this very clear. Otherwise advisers are likely to be contractually obliged to provide a continuous monitoring service. Advisers will be in breach of contract if they fail to continuously monitor clients' investment portfolios.

So it's a good idea to check the wording of your ongoing service agreement to ensure that you are not overpromising and under delivering.

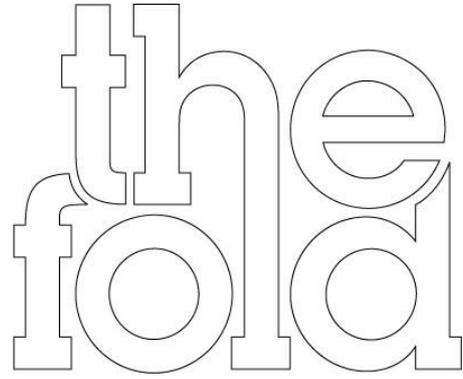
Regardless of the scope of the engagement, if they are paying an ongoing fee, clients not unreasonably expect that their adviser will monitor their investments and tell them if the market is dropping (even between the review intervals that the adviser has contracted to provide). A failure to do so can result in a hefty financial compensation payment, not to mention the time cost and fees involved in defending the complaint.

It's not unreasonable for clients to expect that their adviser will tell them if the market is dropping

And, given that most investment portfolios are (or should be) designed around a pre-determined asset allocation, advisers engaged to provide ongoing services need to monitor portfolio movements to know when adjustments are required to maintain the recommended investment strategy.

Growing use of model portfolios.

Increasingly, advisers are designing (or buying in) model portfolios to gain the advantages of consistency, control and client certainty. Like all



good investment strategies, these contain carefully defined target asset allocations and guidelines for diversification.

For various reasons, it is very important that these are maintained. Firstly, a failure to rebalance to the target asset allocation in a timely fashion can result in significant variations to performance. And where target returns are communicated to clients, there is a strong onus on advisers to ensure that their investments remain within the tolerances of the recommended model.

Only pro-active and timely monitoring can achieve this.

Increased use of MDA services.

While all financial advisers have a fiduciary duty to their clients, MDA service providers are on steroids!

MDA advisers are 100% responsible for selecting and monitoring the client's investments. They are responsible for ensuring that clients' investments

MDA advisers are responsible for ensuring clients' portfolios remain in line with their investment program. remain adequately diversified and in line with the agreed investment program.

Because MDA advisers are only technically required to check in with the client once each year (at the annual review), robust systems are required to ensure that the investments are aligned to the agreed asset allocation and investment strategy throughout the year.

MDA advisers who fail to do so would be in breach of their MDA contract and potentially vulnerable to regulatory action for failing to provide their services honestly, efficiently and fairly.

Impact of the FOFA reforms

In response to the banning of investment commissions in June 2013, an overwhelming majority of advisers now charge clients a percentage of assets under management. While this has minimised the downwards impact on adviser revenues, it has significantly increased the transparency surrounding ongoing advice fees.

Fees are generally debited from clients' cash management trusts or platform accounts, the

statements for which clearly detail all fees paid to the adviser. And not only do advisers need to provide clients with FSGs and SoAs; they must now provide an annual fee disclosure statement and a 2-yearly opt in notice.

Fee disclosure statements must specify the services that the adviser agreed to provide during the last 12 months, confirm which of them were provided and set out the fees that were actually paid for those services.

Clients have more opportunity to scrutinise and object to ongoing advice fees.

The volume of information now required to be provided to clients significantly increases the potential for clients to scrutinise and object to ongoing advice fees.

And, by law, clients must be permitted to terminate ongoing fee arrangements at any time - with little or no advance notice. It hardly needs saying that clients are more likely to end their adviser's engagement if they feel that the fees charged exceed the value of the services provided.

So advisers now need to ensure, not only that they are doing what they promised to do but that their services represent value in the minds of their clients.

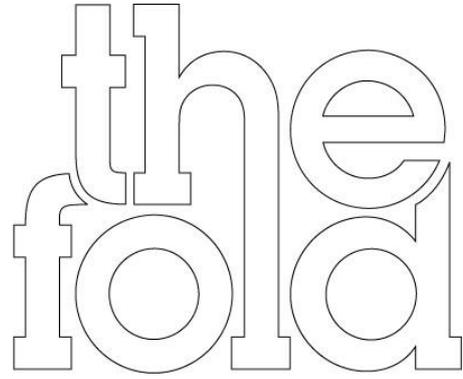
WHAT IS THE IMPACT OF THIS?

Advisers are finding that they need to work harder and more consistently to service and retain clients. It is increasingly important for advisers to be able to demonstrate that their services add value.

The primary attraction of MDA services is the operational efficiencies: there's no need to send an RoA or obtain a client's consent to change an investment in advance. This enables advisers to quickly rebalance their clients' portfolios, take advantage of a momentary over or under valuation of a stock and efficiently exercise corporate actions when required.

They're also an excellent way for advisers to add value to their services – provided you can operate them efficiently.

And as we have seen, the ability to actively monitor, report on and, if necessary, action



changes to client portfolios is essential for three reasons: to meet advisers' contractual obligations, to minimise the risk of professional negligence claims being brought against them and to ensure that they are delivering value to their clients.

FINTECH TO THE RESCUE

Happily, one of the outputs of the fintech revolution sweeping the globe is that portfolio monitoring technologies are becoming increasingly available - and at a price which is accessible, even for small to medium advice firms.

These technologies enable advisers to view all their clients' investment portfolios at a glance, to understand which of them are within the required asset allocation and which need adjusting. Client reports containing appropriate recommendations

Portfolio monitoring technologies are increasingly affordable can be created on demand. Buy and sell orders can be auto generated and routed to the relevant platform or broker.

All of which adds up to safer advice practice and better client service.

MUST I USE THE TECHNOLOGY?

These technologies help advisers to comply with their regulatory and contractual obligations – as well as their clients' expectations.

While it's unlikely that the technologies will become mandatory (much as the providers would like that!), regulators and external dispute resolution bodies are well aware of their existence.

It would be inappropriate for ASIC to have a stated position on any individual regulatory technology;

indeed ASIC doesn't mandate how financial services licensees choose to operate their businesses. But Regulatory Guide 104.90 makes it clear that ASIC expects financial services licenses to have adequate technology to comply with all of their obligations under the law.

ASIC deputy chair, Peter Kell, has repeatedly been heard to say that "appropriate compliance, as well as systems to monitor compliance, are essential" for financial services licensees to adhere to their obligations and that "ASIC expects all AFS licensees to have systems in place to ensure they can satisfy their general AFS obligations".

ASIC is closely monitoring the activities of the UK Financial Conduct Authority which is in active discussions with the technology industry to identify potential ways to support the adoption of new technologies to facilitate the delivery of regulatory requirements.

So it's probably safe to assume that as these types of technologies become increasingly available and affordable, the standard expected of financial advisers will take them into account. Advisers who are unable to demonstrate that they are pro-actively monitoring client portfolios could find it difficult to satisfy the regulator that they have appropriate systems in place.

In a user pays world, where financial services businesses will increasingly be asked to contribute to the cost of operating the regulators who oversee them, this could become quite a costly oversight.

CAN WE HELP YOU.

The Fold has specialist expertise in financial planning compliance, cutting a swathe through the maze of unnecessary institutional practices, to get to the essence of professional advice.

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If you'd like our help with your regulatory or commercial legal issues, email :

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