

YOUR PRACTICE

BY TED RECHTSHAFFEN

Real advice wins

The product pusher—thankfully—won't survive.

I'm biased. I think most of the Canadian wealth management industry has got it backwards.



RECHTSHAFFEN

Case in point, the financial regulators that inadvertently support the product pushers. They're well meaning and do a pretty good job, but they regulate products instead of advice. There's a different regulator for insurance, stocks, mutual funds, and for mortgages—although in Ontario the mortgage regulator is part of the same group that covers insurance.

What we really need, however—and what clients are pleading for—is the true regulation of financial advice. I'm convinced the product pusher cannot survive. The past year has reinforced this belief with investment product pushers being regularly called out by their clients.

Unfortunately, there's still a sizable gap between the needs of clients and what's delivered by much of the industry. I'll illustrate this gap through 10 commonly asked client questions and the typical answers they engender among true financial advisors on the one hand, and product pushers on the other, with the latter responses, sadly, being much more common.

Q1 "I have retirement goals I want to achieve. How will my RSP help?"

FINANCIAL ADVISOR: Let's understand the big picture first, including when you want to retire and what type of lifestyle you envision in retirement. We want to make sure you understand what other income sources you'll likely have in retirement, including CPP, OAS and any other corporate pension income.

Next, we want to understand your goals. Are they short, medium or long-term? In the case of short-term goals, you may, in some instances, want to avoid making an RSP contribution in order to have easy access to funds, and choose TFSA contributions instead. You may also want to lower the risk

profile on RSP assets in case you need to pull the funds.

Most importantly, we'd want to do a conservative projection of RSP asset growth to see whether you're on track for too little RSP saving, the right amount, or as is often the case, too large an RSP.

Relevant questions might also include the likeliness of a meaningful inheritance, or conversely, the likelihood of having to financially support parents.

All this needs reviewing, before we can responsibly say what to put into the RSP, and how to invest it.

PRODUCT PUSHER: The RSP is the best tax shelter available. Most people don't save enough for their retirement. As far as what to invest in, we recommend XYZ Fund or XYZ managed money solution. It's 'safer' (a Balanced Fund) or 'growth-oriented' (an equity fund), and a good choice for your RSP because you are X number of years from retirement.

Q2 "Should I put money into my RSP or my mortgage?"

FINANCIAL ADVISOR: First, let's understand the interest rate on your mortgage, and your level of taxable income. If the mortgage interest rate is low (under 6%), and you are in a 40%+ tax bracket, you should definitely put money into your RSP first. With the tax refund, you're still better off to put that into next year's RSP as long as the low interest rate and high tax bracket remain.

If you're in a tax bracket that's lower this year, but expect to move to a higher bracket in future years, it might be better to pay down the mortgage, and save up the funds to put into the RSP when you're likely to receive a good refund (although you could contribute now and not claim the tax deduction until later).

If you struggle with debt, however, and feel peace of mind having the mortgage debt lower or eliminated, then pay off the debt first.

PRODUCT PUSHER: The RSP is the best tax shelter available. Always put money into your RSP first. You might want to use some of the tax refund to pay down your mortgage, but make sure there's enough money to put your annual RSP contribution in. Without doing this, you're at risk of running out of money in your retirement.

Q3 "Will I outlive my money? If not, how much will I have at the end?"

FINANCIAL ADVISOR: Again, we need to understand the whole picture. This isn't complicated in most cases, but we need to understand your income level, retirement expectations, expenses, real estate value, debts, insurance, pension, and other items that might impact your plans positively or negatively. We need to make adjustments to ensure you're saving the most tax through income splitting, and that at least at the outset of the plan, we're assuming no more than a 6% annual rate of return—we can even use 5% if you want to be extra conservative.

From this analysis, we can give you a fairly clear picture of the likelihood of your outliving your money. We can also tell you the likely size of your estate (estimated), and your lifetime tax bill.

With this information we could help you make some key life decisions today that could impact your retirement age, how much you spend on yourself, how much you gift to children or charities, career choices, hobby choices, etc.

If, of course, you're on track to outlive your money, other decisions can be made to try to continue working, spending less, giving less, etc.

PRODUCT PUSHER: We are going to make you a lot of money in your investments, but to be safe, you want to keep putting more money into your RSP every year. That's the best way to ensure you won't run out of money in your retirement. It won't hurt to cut back on your expenses, but make sure

you don't cut back on your RSP.

Q4 "I need income from my investments to cover my expenses. Can you help?"

FINANCIAL ADVISOR: How much income do you really need? Keep in mind you worked your whole life so you'd have assets to retire on (not the same as having enough assets to generate sufficient income on).

It's always nice to be in a position where you don't have to touch your capital, but some people take on significant risk in their portfolios to achieve the target of living on income. This works fine, but when the income trust market collapsed or the principal protected note market collapsed or when you chased high yields only to see sizable cuts in monthly distributions or dividends, you suddenly saw the amount of risk in your portfolio.

If we can build a cash-flow plan for the rest of your life, it shouldn't really matter whether the cash is a return of capital, capital gains, dividends, interest, pension or a sale of real estate.

Taxes and the makeup of the investment portfolio are both very important, but you shouldn't have them driving income targets. Once we know your target lifestyle, and your entire net worth and pension picture, we can determine the best way to draw this income.

PRODUCT PUSHER: You were making \$100,000 before retirement—and most people spend 70% of their income in retirement—so we need to try and yield \$70,000 from your investments. Because you have \$700,000 in investment assets, you're going to need 10% income. Here's a high-yield income fund with 11% yield, so that should cover you.

Q5 "My mortgage is coming due next year. What should I do?"

FINANCIAL ADVISOR: We need to know a few things first. How big is the mortgage? What are your plans with your current home? Are you planning to move soon? What is your current mortgage rate and structure? Are you happy with it? Have you had any trouble making payments? Have you had extra money to pay down more? What would happen to you if interest rates jumped 4% higher? Is there a penalty to break your mortgage now, and what would it be? Do you currently have non-registered investment assets that could be used to cut or eliminate the mortgage?

Next we'll look at an interest rate forecast for the next three years. While far from an exact science, there are some key interest

rate prognostications, rate trends, prime rate volatility, and others, which will allow us to make a call on where we think rates will go over the next 36 months. Beyond that period is simply too far out in the interest-rate world.

Given that we think interest rates will be going up over the next three years, possibly by several percentage points, you want to consider getting a five-year fixed mortgage today, depending on breakage costs. Given that the mortgage amount is still \$150K, and you're planning to stay in the house for a while, it makes sense. If you're thinking of moving, you'll want an open mortgage or line of credit. If cash flow is a major concern, just get a line of credit.

PRODUCT PUSHER: I don't really cover mortgages, but I would try to get a good rate. You wouldn't want to pay anything down faster with these rates.

Q6 "I hate paying taxes. Is there anything I can do to lower them?"

FINANCIAL ADVISOR: That's a big question and requires some detailed information in order to answer. Here are some of the key questions we need answered:

- > Are you a salaried employee or self-employed?
- > Are you married?
- > What were your gross and net incomes over the past couple of years?
- > What is your current employment status?
- > If retired, how old are you? Your spouse?
- > Do you have a corporation?
- > Did you incur any capital gains or losses? When?
- > Do you have RSP contribution room?
- > Do you have an asset mix of non-registered portfolio?

Some areas we'd specially focus on are income splitting, tax sheltering (using insurance in the case of sizable non-registered assets), testamentary trusts, strategic contributions and withdrawals from RSPs. If you're incorporated, we'd look at paying for more within the corporation using pre-tax dollars, and check if you're a fit for IPPs or RCAs. In the case of private equity, we'd look at holding companies and family trusts, and ensure non-registered investments are dividend-focused, and that all opportunities to deduct losses against capital gains have been explored. If your situation is more complex other strategies will be reviewed.

PRODUCT PUSHER: Maximize RSP contributions. Take a look at

HAS THIS BEAR MARKET CHANGED THE WAY YOU CONDUCT INVESTMENT ADVICE?

A B C

Yes, I am more conservative about the future returns of equities	32.7%	27.4%	34.6%
Yes, I am more uncertain about the future returns of equities	17.0%	17.2%	12.5%
Yes, I am more optimistic about the future returns of equities	17.9%	12.1%	21.8%
No	32.4%	42.8%	29.3%

A. Investment Advisor (Broker) B. Financial Planner C. Insurance Specialist

Respondents: 334, Source: Rogers Business & Professional Publishing Research Group

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Real advice wins

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labour-sponsored funds, capital class funds, and flow-through shares. Tax loss selling is also an option.

Q7 *"I want to make sure my kids and grandkids are looked after. What's the smartest thing I can do?"*

FINANCIAL ADVISOR: Step one is to determine what, if any, funds will be left in an estate given the status quo. In some cases, there will be very little left to the family. If a financial review indicates there will likely be a meaningful estate, then the hard work begins.

We'd want to ensure you have a big-picture goal of what you want to leave and to whom.

We can often help avoid some unintended family conflicts if those goals could potentially open the door to someone contesting the will.

Some people are so concerned about outliving their money they miss the opportunity to help their children at a real time of need. By putting together a conservative plan, we can give you the freedom to help on a lump sum or annual basis while you're still around, if you so wish.

We'd also want to find ways to minimize taxes, and boost wealth once your financial independence is protected and assured. Most clients would rather have their money go to family instead of the government.

If you're a parent, we'd encourage you to have an open conversation with your kids about their intentions, and prepare them so they can plan their own retirements accordingly. It also helps ensure your intentions are well understood. Too often, children misinterpret what is written in a will and are easily offended or hurt. Finally, the will and power of attorney play a key role, but come later when answering this client concern.

PRODUCT PUSHER: You should get a will made or updated. I know a guy I can refer you to.

Q8 *"I want 12% returns. Can you get them for me?"*

FINANCIAL ADVISOR: Possibly, although that would require a pretty aggressive portfolio. Our main question is: Why do you want 12% returns? Is it to maintain your lifestyle? Do you understand the extra risk of poor performance that this portfolio would bring? Are you OK with that?

Let's try to get a better understanding of the risk you NEED to take in order to achieve all

of your key goals. It's quite possible you can be almost assured of meeting your goals by achieving 6% returns. For every 1% of return we aim for above that number, we need to determine if you will still be OK on the downside. If you are truly wealthy you can afford to earn 0% and you can afford to try to earn 15%, it becomes more of a philosophical question. Most of us, however, can't afford the risk associated with going for 15%. Let's build a plan around 6% or 7% and see if that will get you closer to your goals. From there we can determine if you want to lean more aggressively or conservatively. Once you see the likely impact of both, we can agree to a target asset mix, and begin to implement an investment plan that will fit within your larger picture.

PRODUCT PUSHER: Sure. Here's a fund that's made 13% over the past 20 years.

Q9 *"I have been offered an early retirement package at work. Should I take it?"*

FINANCIAL ADVISOR: This can be a very emotional decision. Our goal is to make the financial decisions black and white so you can make the best emotional decisions. We need to get a much better understanding of what's included in the package.

We also need to understand your ideal scenario. If you could do it financially, would you want to retire now? What is the job prospect at your current job or elsewhere, if you decide to turn down the package? In order to answer the financial question, let's look at your family situation, expenses, debt, lifestyle, and all pensions. Once we understand that, and factor in the package, we can see if you can afford to take the package and retire. You may want to negotiate something different than the package if it's a better fit for your needs. It may not be that feasible, but if you know what you want and need, it can't hurt to ask.

As for pure analysis, we want to see if the package will leave you in decent financial shape in comparison to your working for another one, two, five, or fifteen years. Unlike most decisions in this area, we want to give you the tools to make the decision with confidence and to eliminate the guesswork.

PRODUCT PUSHER: That's a tough one. How big is the lump sum payment? If it's a lot of money, you'd want to seriously consider taking it. What are your colleagues doing?

Q10 *"I don't understand what insurance I have. What do I need? Should I change anything?"*

FINANCIAL ADVISOR: Insurance has two main purposes. The first, and most common, is to cover you and/or your loved ones in case something bad happens. This insurance is needed most when you are younger, have a great deal of earning potential in front of you, and when the assets you have earned would not be nearly enough to take care of things if something happened. The second is less common, but is very powerful for the right client. That is as both a tax shelter and an investment vehicle that may be set up to be non-correlated with other investment returns.

To determine what you need, we would take the time to understand where you sit in your life: Whether you still fit in the risk management phase, and how much insurance you would need. We can then do a review of all existing coverage (individual and through work) and determine if the existing insurance

can be reduced, should be replaced and/or augmented. This is all considered with the current budget constraints, and trade-offs often need to be made and understood.

If the opportunity is tax- and investment-driven, it's more about shuffling existing assets. The drawback to insurance is that in some cases the insurance assets are less accessible or structured. Here's where financial planning is key in order to determine an amount that will not put any cash flow needs or living goals at risk, but will maximize tax reductions and benefits.

PRODUCT PUSHER: I'm not a big fan of insurance. If you want, however, I can bring in an insurance person who works here to look at it, but I'll make sure you don't end up getting more than you need.

When we understand the true goals and concerns of Canadians, it becomes clear advisors will need to move away from peddling products. Looking at the answers provided by Product Pushers, how can they possibly expect to stay in business or continue to be well paid for

the level of advice they provide?

But the biggest challenge is convincing Canadians to pay for financial planning. Clients who want good financial advice need to better understand there are no free rides—they get what they pay for.

As more Canadians figure they can be buying funds or stocks on their own, the advice industry will be pushed toward providing real financial advice—not due to any great desire to provide more value, but simply a realization that the easy-money product sale is becoming harder to achieve.

As Canadians better understand what they want and need, advisors need to adapt. Of course, advice-based regulation can help. Greater financial literacy will help as well, but as with all major business shifts, it will be the changing demands of the consumer that drive the change. ^{AER}

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