A Matter of *Interest*

David Choo says the variety of choice that independent financial advisers offer is always in the clients' interest.

The word "interest" is, if nothing else, pretty interesting.

Early in life, we look for interesting storybooks and games. At puberty, we become interested in the opposite sex and learn the difference between "nice from far" and "far from nice".

Then, as we reach adulthood and enter the business world, we learn about bank interest and how important it is to differentiate between simple interest and compound interest. It should be a relatively simple thing but we soon find it can be rather complex.

Instead of making things simpler, it seems most financial institutions are bent on making life more difficult for investors and depositors. Against a backdrop of super-low fixed and savings deposit interest per annum eye-catching offers of double-digit interest for deposits grab our interest.

But we soon lose interest if we work it out and find that the effective rate of interest is far from interesting. Pity the ones who trust their eyes rather than their brain.

To help the public, the banks came up with an advertising code, which states that advertisements presenting interest data should state the effective rate of interest. But it is hard to see where this effective rate of interest is shown in advertisements, if at all.

A person I know who considers herself rather careful about money was shocked when she discovered that the 10-year single premium product she purchased from a bank that promised double-digit interest actually worked to be about a two per cent effective rate of interest.

Like many, she learnt the hard way to take more interest in interest, and pay more attention to the fine print rather than flashy advertisements.

What then are the different types of interest calculations that tend to get people in a tangle? Simple interest is the interest derived from a fixed principal sum. Compound interest is calculated based on an increasing principal sum. The incremental sum for a period is the interest earned on the principal sum from the previous period – in other words, the interest earned upon interest.

Meanwhile, the effective interest rate is the average rate that yields a total return equal to that gained by the actual series of returns experienced. As such, it provides a fair and accurate basis for comparison between two investment choices, which may yield very different patterns of gains and/or losses.

WHOSE INTEREST?

The word "interest" can also be used in other contexts, which are relevant in the world of financial advisories. We hear all too often that business exists for clients' interest and we are sick of the cliché "clients' interest first". What goes unsaid is that businesses must look aftertheir own interests as well, or they would be out of business.

Also left unsaid is that self-interest is so ingrained in human nature that we call anyone who manifests interest in others to the detriment of self a "saint".

Cynics will say that it is in the saints' interest to be interested in others because of eternal rewards. The truth is that we are all motivated by "self-interest", but some more so than others, and some watch out for No. 1 all the time. No wonder parental advice abounds and we should pay heed. Remember:

- Don't trust people who give you gifts (sweets)
- Don't trust stories that sound too good to be true (for they aren't)
- Don't be motivated by greed
- Don't do things just because it is easy or convenient

The wisdom of these statements is simple. "Don't trust people who give you gifts or freebies" because they usually have an ulterior motive. They want to soften you, to make you less careful, and get you to be moved by emotion rather than your mind.

One common research finding I find rather odd but have to agree with is that people generally buy on emotion and justify by reason (rationale). Because of this, many regret their purchases afterwards (buyer's remorse). So, it pays to beware of freebies, whether it's given by people or companies, unless no "sales" motive exists.

"Don't trust stories that sound too good to be true" because they generally aren't. Apart from the scams being offered through the Internet and overseas telephone calls, advertisements which sound too good to be true are often not the real thing.

"Don't be motivated by greed" because it is a powerful and blinding motivator, and stories of great gains often lull us into a higher state of gullibility. This area is more controversial because for some, greed is good in the sense that the "driven" person is better than a backseat passenger.

But here we are referring to how we respond to sales pitches and advertisements, and we must always scrutinise and not be superficial, as well as pay more attention to substance rather than hype. There is a difference between investment and speculation, and there are wise investors and unwise investors. And greed is certainly not one of the hallmarks of a wise investor.

"Don't do things just because it is convenient or easy" because there is obviously a price to pay. Convenience stores serve a purpose of meeting emergency needs. One-stop stations save time and hassle, but it is important to ask what kind of "one-stop station" it is.

There are one-stop stations that do not present choices for your needs or the best value. For example, most financial institutions that claim to be one-stop stations offer only one life insurance company's products and a limited choice of unit trusts.

In other words, you probably can have most of your financial needs met but you cannot get the range available in the market. For small purchases like tissue paper or sweets, having choices may not mean much savings, but when you commit for the long term to something like insurance products, the savings from choosing the best value product are significant and may be in the thousands of dollars. One-stop stations that are brokerages tend to offer a wider range of choices and generally would be safer bets.

EXAMINE THE ADVISER

But how do you tell whether an adviser/agent or a firm is offering limited choice or a wide range of choices?

Firstly, the Financial Advisers Act and its Guidelines and Notices require every adviser/agent to disclose which product provider or providers he represents or can do business with. Insist on knowing this, if the information is not volunteered. Job titles can be quite confusing and do not reveal much.

Secondly, ask for a comparison of at least three product providers. The advisers who are able to offer choices will be able to provide this, whereas the limited or tied advisers will not. The different product providers have their "champion" products and their lacklustre products. If you do not ask for comparisons, you may be purchasing a lacklustre product without knowing it, or realise it too late to be able to do anything about it.

If you are fortunate enough to realise you have purchased something not in your interest within the "free-look" period, you can ask for a reversal of the sales transaction without penalty. If you miss this chance, giving up your sale may cost you some charges or the loss of value of your investment.

So, how do you take care of your interest? You must know what "interest" you are getting and what the effective rate of interest is. Insist on this and you will be surprised how many financial advisers will not have it ready. Be patient and get them to calculate it. If they cannot do so, you are forewarned about the calibre of the adviser, regardless of whether he is an agent, an employee of a financial institution or anindependent financial adviser.

Then ask for market leaders or best value products, and get the advisers to demonstrate to you the basis for recommending the "best" product. Remember that the majority of advisers are not independent and only have to show "reasonable basis" for their product recommendation - even a choice (or more rightly, no choice) of one product only can be "reasonable".

Those who are independent will disclose that they are able to provide a comparison of products of at least four product providers. They are expected by the provisions of the Financial Advisers Act to provide product recommendations based on more than reasonable basis – they have to pass the test of "fair and objective" basis. Ask for the product providers with which they are able to do business, if they do not disclose this voluntarily. Ask for comparisons and be thorough about product selection.

INDEPENDENCE

You will notice that in the last sentence, I mentioned that you should "ask for the product providers with which they are able to do business". Notice I didn't use the more common term "which they represent". This is because tied insurance agents or advisers of certain financial institutions are legally agents of the principal companies which they represent, and they are, to date, not licensed by the Monetary Authority of Singapore.

In contrast, licensed Financial Adviser firms and representatives represent clients' interest and are not agents of the product providers. Your interests are better served by these licensed Financial Advisers, especially if they are independent, because they owe you a duty of care. They are obliged to take care of your interest. This is a great matter of interest, to say the least. **si**

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