



Protecting clients from their children

Parents are increasingly offering financial assistance to children and their spouses when buying a home. But what happens if the marriage fails? **PETER BOBBIN** and **NABIL WAHHAB** look at the legal implications for advisers.

Significantly increased property prices over the last few years have more and more young people thinking that they will miss out on buying their own piece of Australia – the first great Australian dream seems too elusive to many of them.

The solution to their nightmare has come from the banks and other lenders who, seeing an opportunity to lend

yet more monies for real estate, have started promoting parent supported home loans (PSHLs).

Have any of your clients provided PSHLs? How should you treat these? Are financial advisers and their dealers liable for those that fail? And if we have the client's interests at heart, should we encourage or warn against PSHLs?

Essentially, there are two types of PSHLs:

- parents who have lent or will lend their children large sums of money to use as a deposit on a home; and
- those who use their own house as additional security.

Most parents, while being very generous with their children, do not consider or are unaware of the effect a PSHL may have on their own

retirement plans; a PSHL is an emotional 'investment'.

What can go wrong?

Take the parents who 'give' \$200,000 to their daughter to use as a deposit on a home. She soon meets someone nice and gets married. All is well so far. Unfortunately, she finds out her husband has been cheating on her and the marriage fails within two years.

Did the parents intend the money advanced to their daughter to be a loan or a gift? What will happen to the money when the daughter and her husband end up in the Family Court arguing about their property? How will the Family Court view the money advanced by the parents? How will the parents protect themselves if they had at all times wished for the money to be repaid by the daughter?

What is your responsibility? Should you have told the parents not to do it? Was it your responsibility to tell the parents that they must document the loan?

Should your Statement of Advice (SOA) treat the loan to the daughter as a cash investment or a non-asset? Is your responsibility different if the parents came to you with the loan already in place or if they consult you as to what assets to cash-in to provide the loan? And is the responsibility any different if the PSHL is supported by a mortgage over the parents' home or investments?

The need for documentation

Documenting the PSHL is generally hard for parents and children to deal with at the time the daughter or son purchase their home. Everybody is excited at the prospect of the new home and during happy times people forget about the paperwork and the consequences of what may happen in the future.

Financial and legal planning, however, are crucial for the parents' retirement plans and for their children to ensure the money advanced is protected and not shared with a cheating spouse upon marriage or relationship breakdown.

Financial planners and their dealers have been found at least partly liable for the failure of 'investments', even when these investments were not recommended by them. Where the nature of the investment, if lost, is such that its loss would have a clear and obvious impact on the financial plan prepared for the client, the financial adviser must warn of the risk of maintaining that investment.

You need to warn the client: keeping the loan or investment is detrimental to the health of your wealth and the achievement of these financial plans.

So, if a client comes to you and says "young Jenny is getting married and we are going to mortgage our house to help

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“ Someone will look for someone else to blame. You, as the financial adviser, may be the only one with money, or the appearance of it. ”

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get them started in their own home”, you must, if you are a full service financial planner, not only warn them of the financial risk on their investments if young Jenny fails to repay the home loan, you should advise them against it.



Peter Bobbin

Family Court interpretation

What can go wrong? Where parents have advanced money to their daughter, for example, without documents and the daughter’s marriage later fails, the Family Court will not ignore the advancement. Depending on whatever evidence is available, the way the court will deal with the loan may be significantly different from what was expected.

If the loan was not documented, the court will take it into account in determining the contributions of each of the parties and their respective entitlements to the property accumulated between the husband and the wife.

By taking it into account, one cannot gauge how the court has dealt with the money. That is, one is unable to ascertain whether the court has deducted the full amount advanced from the pool of property and allocated the money to the daughter or whether the court takes into

account the money advanced in a broad brush manner that may discount the amount advanced significantly.

Generally, the court will take the loan into account as a contribution on behalf of one of the spouses. However, it is not the most effective way parents can protect themselves and their children in the event of separation.

Highlighting the risks

In this day and age, where approximately 42 per cent of first marriages fail and 50 per cent of second marriages fail, it is important that parents turn their mind to the issues prior to any PSHL. You, as the adviser, should ensure that your clients turn their minds to the risks they are embracing.

The most effective way for parents to protect themselves (and their children) is to have a deed of loan and a mortgage between themselves and their child. The deed of loan could provide that the advance will be repaid back to the parents in the event that certain triggers come into effect such as death, separation or some other event, perhaps with interest to be paid at payment date.

Certain taxation issues will need to be considered in relation to any interest clause to ensure that the parents are not deemed to have received the interest though it may never have been paid.

The way the court will deal with a case where there is a deed of loan will be significantly different to how the court will deal with it without any paperwork. While the court still has some discretion, it would be difficult for the court to ignore a deed of loan, especially if it is supported with a mortgage.

The effect of this is that the court, in determining the asset pool (which is the first step in its enquiry), will reduce the asset pool by the amount of the loan outstanding. That



way, the adult child is protected and so are the parents’ interests.

Legislative changes

Recent amendments made to the Family Law Act entrench the right of third parties to be joined in court proceedings between divorcing spouses. The effect of the new amendments will be that parents may have more incentive to intervene as parties to the Family Law proceedings, seeking the repayment of monies advanced by them. This will only be most effective where the parents have a deed of loan.

And if the deed of loan arose out of your (reluctant) acceptance of your clients’ insistence, you will also be protected by it and your reluctant advice.

The risks to you as a financial planner are likely to be much greater where the parents provide a guarantee against their own home to enable their adult child to buy a home. If the adult child and their spouse separate, and

there is a shortfall after the sale of the house, the parents’ home will be on the line. The parents will also incur significant legal costs in trying to recover the money from their child and their former spouse. Worse, their home may have to be sold.

Taking legal action

Given the above circumstances, the parents may have to join the proceedings in the Family Court between the child and the spouse seeking injunctions against the bank to prevent it taking possession of their home and for the child and their former spouse to indemnify them against the shortfall.

This is a big mess. There could be issues about whether the Family Court can entertain the later application. The legal costs and the default interest that has to be met will be significant until the court determines the matter.

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Nabil Wahhab

or the appearance of it.

While banks and financial institutions are keen to unlock the equity of their clients to allow them to help their offspring, parents and their children have to be aware of the traps such a wonderful opportunity may present. And as an adviser, so do you.