Submission - Quality of Advice Review

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The Treasury
Advice and Investment Branch
Retirement, Advice and Investment Division
Treasury
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My submission:

Pre-amble
The concept of Quality Advice may be incongruous to being affordable and accessible. Simple Advice seems to be more aligned with advice being affordable and accessible. There are a number of barriers to the provision of simple advice and this submission will suggest ways to deal with that problem. None of the issues or suggested solutions can work on their own – a co-ordinated approach is needed.

I suggest that some of the issues are:

- That not everyone wants to obtain financial advice.
- That advice is typically more complex than many think, including regulators.
- That strict interpretation of the Corporations Act definition of Financial Product Advice stymies strategic, or non-product specific advice.
- That raised education standards need to come with some protection of the profession.
- That a transition to self-regulation is necessary to remove the multi-disciplinary regimes effecting confidence in providing advice.

The main focus of this submission is the last point, and the main body of the submission will deal with that.

Not everyone wants to obtain financial advice

There are three distinct groups when advice is typically considered: Those with the means and inclination to afford professional advice, those who may feel they do not have the means to afford professional advice (but may have) and feel that there may be limited benefits, and those who clearly do not have the means to afford professional advice and where the benefit of professional advice is limited best.

The focus on many reviews has been on the middle group and the reasons they do not seek advice are numerous including lack of trust, lack of understanding of the value that can be added and an unwillingness to pay for advice under any circumstance as a result of the above.

It is perhaps at best questionable to suggest that the third group will ever engage with financial planners or digital advice. This group will always rely on government support throughout retirement.

Recommendation:

> *A campaign to showcase the benefits of financial advice from a government body would improve legitimacy and confidence in qualified and registered financial advisers.*

Advice is typically more complex than many think, including regulators

The complexity of the Australian Financial Planning environment, especially but not exclusively, the laws and regulations involving superannuation, supports the need for higher education standards. Along with particular complexities relating to life insurances, Centrelink, investment planning, debt management and cash flow management, the ability of non-qualified individuals should be excluded from the advice process.

Recommendation:

> *Be extremely cautious of allowing other ancillary professionals to provide financial advice without the same rigid educational standards as current financial advisers.*

That strict interpretation of the Corporations Act definition of Financial Product Advice stymies strategic advice at a lower cost

At present, the key phrase in the Corporations Act that defines financial product advice, and applies the entire regulatory burden, is any inference that encourages an individual to buy, hold or sell a financial product. This is an incredibly broad definition that was intended many years ago to 'deal with' issues regarding commission sales where there were transactional benefits to advisers. Those days are long gone, but the definition applies to such phrases as 'top-up your super' or 'match your investment portfolio to your risk profile'. There is not even any materiality regarding this so a recommendation to invest say, $10,000 into a diversified investment requires a Statement of Advice.

I'm sure that many advisers would offer a lower cost service to clients who wanted 'strategic' advice with no product recommendations if the lack of specific product recommendations was excluded from the requirements of disclosure applicable to a Statement of Advice. To re-iterate, a

recommendation even to stay with your existing (say) super fund is a recommendation to hold a financial product and so is ‘caught’ within the regulatory burden of Corporations Law.

Recommendation:

> *Differentiate product specific advice from non-product specific (strategic) advice and reduce the disclosure burden on advisers thus allowing for a lower cost service to be offered.*

Raised education standards need to come with some protection of the profession.

The barrier to entry has been raised and unless a lower level of qualification is introduced with some limits to advice attached, it will be challenging to build the profession to the size it needs to be. The current raised education standard for all mean that only those who can afford the time and financial burden of higher education are eligible to enter the profession, Further, this is only after completing a full-time professional year in an environment where many practices are too small to be able to afford the time and money to pay for a non-productive staff member for that length of time.

The short-term solution might be to consider allowing accountants to offer financial advice, however, accountants graduate often with no courses in financial planning, or at best a generalist subject called ‘Introduction to Financial Planning’. This clearly flies in the face of the specialist education pathways that have been imposed on often experienced financial advisers who have had to materially and retrospectively complete new courses.

Recommendation:

> *Not to allow accountants to offer ’Limited financial advice’ without allowing a lower level of qualification for financial advisers so that they might have an easier pathway to the full professional financial adviser status.*

That a transition to self-regulation is necessary to remove the multi-disciplinary regimes effecting confidence in providing advice

The regulatory framework for financial advice and planning has the same origins as financial advice and planning itself – the sale of life insurance and, later, investment products.

In the past, up-front commissions were high, and churning was rife. The increased focus on the disclosure of fees being charged to the client's account was a reasonable solution to the problem and certainly had the effect of reducing churning (perhaps not so much with life insurance sales). Back then, the switching of financial products was easy, and the multiple charging of up-front commissions was a genuine problem that needed to be dealt with.

The industry's solution to the problem of churning was to start to pay a trail commission in the hope that it would disincentivise the constant rolling of products. This change certainly did have the effect of reducing the churning, but the disclosure was a one-time disclosure. It was never intended to be a fee for service, and this is perhaps why the regulator excluded these payments from the FDS requirements for so long.

The Statement of Advice became the primary disclosure document, and we were told to stop calling our financial plan a financial plan and instead use the specified but legalistic term "Statement of Advice". As a disclosure document, it was taken over by the lawyers who to this day insist that if something is disclosed, there is no responsibility for it – despite the courts and other lawyers insisting that this is not the case. Hence the document morphed from a simple document that outlined what was being recommended into a legal document that often ran to over 100 pages.

Don't get me wrong; this is not all the fault of the lawyers. Advisers and planners started charging fees for the preparation of this document, and often these fees were not justified by the value of the recommendations, and so they began to charge based on 'weight'. A big thick document must be worth at least three or four thousand dollars – right?

And then there is the issue of education. We got it quite right towards the end of the last century when the Diploma of Financial Planning was the pre-eminent qualification. Run by a University (Deakin) and sponsored by the FPA or taught at the Securities Institute of Australia by experienced industry leaders on a face to face basis. It was a full eight-unit program that covered all the main areas of financial planning and advice.

Then the Federal Government opened up the Registered Training Organisation (RTO) debacle, and the free-for-all race to bottom began. Why do an eight-unit two-year diploma when you can do the 'same' diploma in 6 months (or four weeks)? Even ASIC got in on the act by introducing RG146 which said that any course was adequate provided that the licensee was satisfied – effectively wiping their hands from any form of quality control. Many still did the full eight-unit diploma, but they were being undermined by the 'new standard' of RG146.

So that's the history lesson – where to from here?

Well – up-front commissions are a thing of the past as they are banned regarding superannuation and investments. Commissions for life insurance recommendations have been standardised and reduced significantly, which overcomes one of the main issues with commissions – the allegation that agency theory suggests where Advisers look for the products that pay the highest commission. I realise that there is still an issue of potentially over-selling insurance, but this is much less likely in the era of the best interest duty (more on that later).

Trailing commissions have all but ended, and advisers have moved to a 'fee for service' method of charging clients. Disclosure of these fees has become either one, two or three-yearly, and there is a definite move towards annual disclosure and engagement.

Education is being substantially increased technically, although the majority of professional advisers will find it difficult to learn anything materially from the current courses on offer as these courses, despite being degree level or equivalent, offer less relevant information than the original DFP from 20 years ago. Notwithstanding this, at the end of this year, we will have all proved that we could act ethically and understand the regulatory framework that we have been working within for the past number of years.

Well, if we have:

- Removed the major issues surrounding Agency Theory
- Increased the educational standards to a degree level
- Removed commissions in all but a very limited way
- Demonstrated that we understand ethics and regulation

Surely it is time for financial planning professionals to begin the process of self-regulation.

Where we find ourselves is in the frustrating position of having rules and regulations imposed on financial advisers by people, who are fundamentally disconnected from financial planning. Partially this is our fault – we have never tried to formulate a coordinated approach to regulation. Further, vested interest has been the winner regarding submissions to regulators and legislators, especially as it applies post-hoc to regulatory measures floated. Short time frames for responses, an inability to produce evidence to support requirements and often different needs have all led us to this point.

- We operate in a highly regulated environment with rules imposed on Financial Advisers and Planners which bear little relationship to the quality of advice that the end client receives.
- Whether or not a disclosed fee is re-disclosed every one, two or three years has no impact on the outcome for the client.
- Whether or not the advice document is legally required to have the title "Statement of Advice", when it is a financial plan, does not change the content therein.
- When twenty emails and five phone conversations don't meet the requirements for client service, but a single document called a client review does.

So, where to?

In two words; Operational Standards.

'Safe harbour' provisions should be judged by peers, based on what is an acceptable practice by other financial advice professionals. Only then do practices 'outside the norm' require special justification. Of course, I am not talking about paperwork and forms required, or signatures in specific places, or onerous timeframes, or other 'business practices' as they may apply to a traditional regulatory environment. I AM talking about really practical things like a standard risk tolerance process (or perhaps even 'authorised' risk tolerance processes. I AM talking about standards regarding what information is required to be collected and stored regarding the client and their goals and objectives (standard data collection). I AM talking about standardised risk classifications for assets/investments with uniform categories so we can identify what, for example, a 'balanced' investment portfolio might consist of. I AM talking about an agreed-upon formula or formulas for calculating personal insurance needs. I AM talking about standardised assumptions for financial modelling (dynamically updated to reflect existing market and economic conditions). I AM talking about what constitutes independence.

I AM especially talking about practicing, experienced Financial Advisers and Planners developing these standards, along with academic support, in a true partnership where the results are accepted by the regulator, the courts, the complaint's bodies and Government. Maybe even the Professional Indemnity insurers.

Before I go on, I want to make it clear that I strongly believe that standards cannot be too prescriptive. They need to allow enough flexibility to allow for differences in the delivery of any advice provided, but there should be boundaries. If an Adviser or Planner wants to move outside these boundaries, that is when the justifications are needed, and the grey area should exist. If the grey area can be justified – great. If not, well, you should know the risks.

Only when we move to a position where a group of educated peers can reasonably evaluate the advice will the regulatory burden be relaxed. We need to collectively work towards this so we can lead, rather than follow, the regulators.

So how can we get there?

If we take a leaf out of the medical profession here, organisations like the AMA have special interest groups that inform the policy of the organisation and Government. Experts in the fields become a part of these groups, and they have clout! They are resourced with research grants and funding to produce evidence-based recommendations for the betterment of the community, and they also produce spokespeople who can talk with expertise in their fields – something we lack in our profession.

Of course, it also means that the way 'I' have always been doing things may need to be modified to meet the standards, and this can be challenging in the ego-driven world of financial planning and advice.

Recommendation:

In academic terms, a “Delphi’ approach is most likely to produce the outcome that is appropriate. Groups of qualified professionals work together through a number of iterations to produce a consensus regarding appropriate practices. A government department co-ordinated, but practitioner led (elected) body to oversee the academic approach to determining practical financial planning standards would provide safe harbour to advisers who adopted the ‘approved’ approach to the provision of advice.

Thank you for your consideration.