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Secretariat, Quality of Advice Review
Financial System Division
Treasury
Langton Cres
Parkes ACT 2600
By email: AdviceReview@treasury.gov.au

Dear Sir / Madam

RE QUALITY OF ADVICE REVIEW DIVERGER SUBMISSION

Thank you for the opportunity to provide a response to the Australian Government – The Treasury, Quality of Advice Review Issues Paper.

Diverger manages three core Licensees that each offer full financial advice services to Australian consumers, including many accountant advisers that provide limited SMSF advice and is also a service provider to small Self Licensed Advice firms operating their own AFSL.

Diverger strongly believes in the value of advice and the future of the advice profession and supports much of the improvements that have enhanced the profession over the past years. The following pages highlight our key points and opportunities relating to the Quality Advice Review.

Diverger has separately endorsed a Joint Licensee Submission to the Quality Advice review.

Please do not hesitate to contact us should you require any further information or clarification with respect of this submission

Yours faithfully

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Nathan Jacobsen
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1. Financial Product Advice, General Advice and Personal Advice
Terms of Reference 3.1.1

Current definitions of advice are insufficient as it is difficult to give information or strategic advice to consumers without that information being defined as Financial Product Advice then subsequently construed as Personal or General Advice.

It is unclear how advisers can give financial advice where it does not involve a financial product.

A large part of the value for clients of advice is the strategy, not the actual product that will implement the strategy. Providing strategy advice before product and separate to product advice is an important step of the advice process and an important service for clients. However, it is currently difficult to provide due to the linkage with class of product advice, which requires more onerous disclosure documentation, i.e. a Statement of Advice.

This means that advisers cannot efficiently communicate strategic options for clients or limit or scale advice to the strategy where limited conflict exists, yet the documentation expectations remain the same. The situation makes it harder for clients to receive limited or scaled advice because advisers do not have the confidence to provide an overarching strategy within which the limited advice sits.

There is no clear differentiation between advice and Information.

The term ‘General Advice’ creates confusion to consumers and providers due to inclusion of the word ‘advice’. A client does not understand the difference between the two terms and reasonably assumes general advice is personal advice. An adviser does not have enough clarity on the rules of providing general information that relates to a consumer need without it being construed as personal advice. Clients are missing opportunities to receive general information or general advice from advisers, delivered cost effectively.

Also, advice can be provided under the guise of general advice when in fact personal financial product advice is being provided under the current definition of personal advice.

Recommendations

a. We suggest a distinction between personal advice that includes product class (I.e., personal strategic advice) vs personal advice that recommends a specific product). An adviser to keep records of this strategic advice that can be requested by the client, like Record of Advice obligations.

b. We also suggest a similar approach apply for Intra fund advice so that super funds can also provide strategic advice to existing members without the needs for a statement of advice.

2. Scaled Advice

Terms of Reference 3.1.1

Scaled or limited advice is valuable for consumers. However, it is difficult to provide limited or scaled advice because of the obligations in the safe harbour provisions, in particular Step 7. This requirement has created uncertainty, with advice providers taking the approach to consider all other things and subsequently including those areas in the advice process and advice document, particularly if their authorisation includes those other advice areas. Other professions can manage a single issue and use their professional judgement and meet their fiduciary duty to decide whether scaled or limited advice is appropriate.

Recommendations

Remove the safe harbour provisions as the Code of Ethics provides the ability to scale advice if acting in the client best interest and having clients informed consent and understanding to proceed.

3. Safe Harbour

Terms of Reference 3.1.2

The concern with Safe Harbour is that the provisions, although optional, are applied literally and treated as a must have (not following them is considered by many advisers, licensees and auditors to not in principle meet the legal requirements) and every step must be completed in order. The problem with the current design is that completing all the Safe Harbour steps does not necessarily translate into advice in the clients Best Interest. Safe Harbour has tainted the advice process and focuses on the documentation rather than the quality of the advice or the advice outcomes.

Conversely, best interest advice can also be provided without evidencing all the Safe Harbour steps verbatim. As the provisions require an adviser to evidence each step for each client, such as research for a product they have already researched for other clients.

Safe harbour has moved focus to the process not the outcome and has been superseded by the Financial Planners and Advisers Code of Ethics. They are therefore redundant in their practical usage.

Recommendations

a. Safe harbour steps to be removed from 961B and instead amended and used in ASIC guidance.
b. ASIC to provide continued guidance to meet Best Interest Duty.

4. Advice Documents

Terms of Reference 3.1.3

Statements of Advice are overly complicated and longer than necessary. This is due to section 947B (2) (b) requiring a Statement of Advice to include information about the basis on which the advice was given. While 947B requires advice to be clear, concise, and effective, this does not explicitly exclude the requirement for

including information to support the basis of advice. Consequently, the content is largely open to interpretation resulting in overly complex Statements of Advice that includes supporting information and education material which often add little value to the client or bury the important amongst complexity. This is important as the complexity of disclosure leads to information overload for recipients of advice that can result in unintended consequences[1].

The purpose of disclosure is to inform recipients of advice about conflicts of interest and to facilitate informed consent. However, the empirical evidence does not support disclosure as a primary regulatory intervention to resolve the issues of agency and information asymmetry in professional financial advice. The Code of Ethics requires financial advisers to avoid actual conflicts of interest and demonstrate reasonable grounds that informed consent has been provided. Appropriately targeted disclosure that supports informed consent should be the goal of quality financial advice[2].

The production of a statement of advice currently involves a large amount of time and cost in preparing an essay style document when it is already expected a professional bound by the Code of Ethics can use professional skills to impart advice effectively and ensuring the client understands and make an informed decision. This has had the further unintended consequences of financial advice becoming unaffordable.

In conclusion, the empirical evidence does not support disclosure as a primary regulatory intervention to resolve the issues of agency and information asymmetry in a professional financial advice. The Code of Ethics requires financial advisers to avoid actual conflicts of interest and demonstrate reasonable grounds that informed consent has been provided. Appropriately targeted disclosure that supports informed consent should be the goal of quality financial advice. This would be supported by a review of the Code of Ethics to ensure the standards are fit for purpose. The norms that once existed have been removed, yet regulation and to some extent the Code of Ethics have been designed to counter issues that no longer exist

Recommendations

a. More clarity from the regulator on the terms used in s947B, whether statements can be brief, and removing the basis of advice information from Statements of Advice so that they can be brief, supported with working papers in the advice file.

b. We suggest the regulator provide standardised information, (such as that already on Money Smart and as an example, is provided by the ATO for tax and SMSF related information), that could be referred to in statements of advice, instead of being included in a statement of advice.

5. Annual renewal and payment

Terms of Reference 3.1.4

[1] See Appendix – Disclosure and Informed Consent, for a detailed explanation of the empirical evidence that supports this statement.
[2] See Appendix – Disclosure and Informed Consent, which outlines the empirical evidence and explains that the original intent of disclosure was to resolve issues and norms that no longer exist resulting in unintended consequences.

The requirement for an annual consent for ongoing advice fees is overall a better consumer outcome, as clients are aware of fees from products and it demonstrates the control of these fees are in the clients' hands, where they should be. This can only further enhance the adviser's professional reputation.

However, the EFDS disclosure requirement with annual renewal has added a further cost to an advice business as it is operationally complex with large financial risks attached to mistakes, even if those mistakes do not detriment the consumer. Further, the fact that a client must provide consent to deduct fees from products each year is already evidence the client agrees to proceed with a continued advice relationship. This is further complicated by Product providers who are treating anniversary dates and consent forms differently.

There is duplication of existing disclosure already provided to a client in existing advice documents and processes.

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Recommendations

a. We suggest the enhanced Fee disclosure regime be reviewed post the transitional year and after it has been in practice for at least 12 months.

b. We also suggest ASIC to provide a standardised Enhanced FDS template like the example Product Fee Consent form. The guidelines would include examples of correct and incorrect details.

c. ASIC to provide clear guidance on its position on the circumstance where a fee does not exceed 12 months and is restarted annually, i.e. Fixed Term Agreements.

6. Limited AFSL
Terms of Reference 3.1.7

Accountants represent a large opportunity for the provision of financial advice due the nature of accounting services and a long history as a trusted source of advice, therefore should remain active in the provision of advice.

A benefit of the licensing regime has been the increased education standards around SMSF; however, this has not necessarily translated to increased education in other product class areas such as insurance.

The advice rules impact accountants the same as they do for all financial advisers, in that advice includes class of product advice and a statement of advice is required for class of product advice. This impedes efficient delivery and increases the time and cost of advice, for example, simple contribution, withdrawal and tax related advice related to superannuation.

Recommendations

a. Retain the obligation for accountants providing financial product advice to be licensed or authorised to maintain level playing field.

b. Retain minimum competency, education and training requirements.

c. Allow accountants to also provide product class advice that does not include a financial product (i.e., strategic advice), without the obligations of a statement of advice.

7. Wholesale Clients
Terms of Reference 3.2

The Wholesale client test and sophisticated investor tests are not equal, however essentially lead to the same outcome of advice being outside the retail advice framework. This creates a risk to clients in that retail consumer protections are not available should things go wrong and can lead to potentially unhealthy decisions to class clients as wholesale clients to achieve a commercial outcome for the business rather than the clients' interests.

A client's wealth does not demonstrate financial sophistication.

Recommendations

a. Remove the label Wholesale and replace with Sophisticated and require the classification of Sophistication to be qualified based on an assessment by the advice provider.

b. Evidence that the client has free, prior and informed consent and that they opt out of retail advice and relevant protections and appropriate warnings are provided.

c. The classification to relate to the individual and 'look through' the vehicle they are investing from i.e. Superannuation interests.

8. Design and Distribution (Target Market Determinations)

The Quality Advice Review has asked "Do you consider that financial advisers should be required to consider the Target Market Determination (TMD) for a financial product before providing personal advice about the product?

The TMDs, introduced in October 2021, are well intentioned as designed to assist product distributors confirm their product is suitable for consumers and assist consumers to determine if the product is suitable for them.

However, once advice is overlayed, the assessment of the TMD becomes redundant and an unnecessary compliance overlay as the advice process considers many more factors than listed in the TMD. Hence, the provision of the personal advice exemption, however in practice advisers and licensees are completing additional unnecessary work, despite this exemption.

Recommendations

a. Exclude financial advisers from the definition of product distributors for the purpose of TMD and reporting.

b. Include TMD for non-retail and non-advised services.

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Appendix – Disclosure and Informed Consent

The primary purpose of disclosure is to inform recipients of advice about conflicts of interest. Evidence however confirms that disclosure has little impact on consumer behaviour and may in some circumstances lead to more conflicted advice (Sah, 2017, Loewenstein et al., 2011, Sah and Loewenstein, 2014). A further objective of disclosure is to facilitate informed consent. However, the complexity of disclosure leads to information overload for recipients of advice that can result in unintended consequences (Richards and Safari, 2021).

Research has demonstrated that the best way to deal with conflicts of interest is not disclosure. The remedy is to remove the professional norms that embed conflicts of interest (Sah, 2017), for example conflicted incentive payments to financial advisers. These norms have been addressed by the Code of Ethics negating the need for complex disclosure documents.

To facilitate informed consent the complexity of disclosure has resulted in advisers filtering information to ensure recipients of advice can comprehend onerous disclosure documentation (Richards and Safari, 2021). Filtering is akin to behavioural finance's "Nudge Theory", which promotes an optimal choice without restricting options (Thaler and Sunstein, 2009, Franklin et al., 2019). In other words where a financial adviser filters or manipulates information to assist their clients to make optimal choices.

An example of a "Nudge Theory" is mandated default options in superannuation (Benartzi and Thaler, 2001). The reason for this policy intervention was due to complexity and information overload members of superannuation funds face when choosing investment options. Research demonstrated that members did not choose optimally but rather accept the default option. Therefore, in the absence of optimal choice the default options should be in a balanced risk profile (60/40) to enable potential retirees achieve a better long-term outcome.

However, critics of nudge theory argue that it promotes manipulation rather than respecting the autonomy of free, prior, and informed consent. But, in reality a value neutral presentation of facts is impossible, choices are always made within contexts (Brooks, 2013). This is important as it goes to the central core of a professional financial advisers' role.

Informed consent can be defined as - "*when permission is granted in full knowledge of possible consequence"* (Faden and Beauchamp, 1986). Free, prior, and informed consent implies that a recipient of financial advice is free to choose based on the concept of an autonomous person, that is where a person can choose to act freely. However, there is an important distinction between a person who has the capacity to be independent and in control and whether their actions reflect the exercise of their autonomous capacities.

The reason this is important is that an autonomous person can and often do not make autonomous choices due to temporary constraints such as ignorance of their options. Recognising these constraints, standards four and five of the Code of Ethics encourage financial advisers to recognise their client's capacities and perspectives

and their rights to be free to act. The practical concept of informed consent is that recipients of financial advice generally make substantially autonomous choices (Faden and Beauchamp, 1986).

The Code of Ethics confirms this reality with the statement that an adviser must be "reasonably" satisfied that a client has provided free, prior, and informed consent. This practical outcome facilitates the principles-based approach of a substantially autonomous choice. Therefore, substantially autonomous actions can occur that demonstrates an adviser can be reasonably satisfied that a client has provided free, prior, and informed consent. But appropriate conditions must be met for this to occur. This is important as it requires a financial adviser to facilitate or nudge their clients to making an informed decision.

In practical terms a financial adviser will have established a reasonable basis that a client has provided informed consent if the client;

a. receives appropriate disclosure regarding the advice from the adviser;
b. comprehends the disclosure;
c. acts voluntarily in agreeing to advice;
d. is competent to agree to the advice; and
e. fully consents to the advice.

Finally, a financial adviser if called upon must be able to provide evidence of the above five conditions.

Competence is the gatekeeper for informed consent (Faden and Beauchamp, 1986). To comprehend disclosure, they must be competent to do so. Disclosure does not demonstrate competence (Cocanour, 2017). The key question is to understand what they need to be competent at and how is that demonstrated?

A person can be competent in some tasks and incompetent in others. The question of how to determine if a client is competent to provide informed consent is a normative one. The initial place to start is to determine what abilities are required in each situation, and what is the minimum threshold of the abilities required to make an informed consent decision. Consequently, to answer the two questions posed and to be able to justify the answers an empirical test is required.

In an advice situation a financial adviser would need to determine;

1. what relevant or specific abilities does a client require;
2. what is the threshold level of the abilities (1); and
3. an empirical test for (2).

There are tools available to assist an adviser determine relevant abilities to demonstrate informed consent. For example, a literacy test that determine if a client has a minimum level of competence required to provide informed consent. These tests and follow up targeted education are an example of another prominent behavioural intervention strategy called "Boosts" which promote individual capabilities to demonstrate the capacity of a recipient of financial advice to comprehend the choices available to make an informed decision (Franklin et al., 2019).

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