Quality of Advice Review – The Treasury

By J Wadsworth (BCom & BFin)

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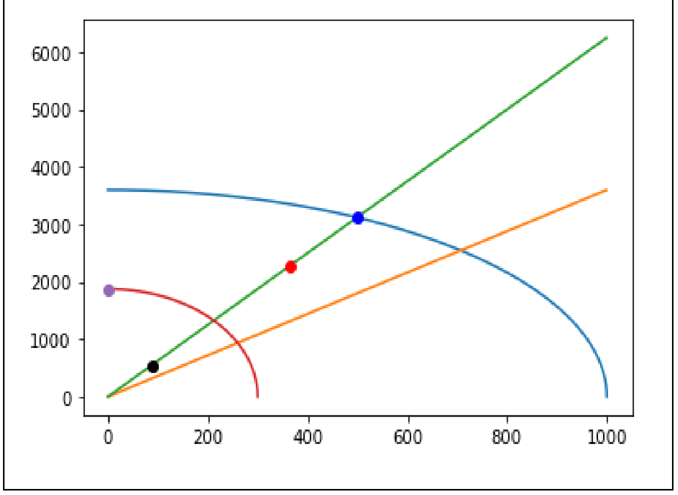
I have experience in financial services and accounting since 2013 working at various Australian Financial Services Licences (AFSL), a public accounting firm and an Australian bank. I studied a Bachelor of Finance (Majoring in Financial Services and Planning) in 2019, and a Bachelor of Commerce (Majoring in Economics) in 2017 at University of Canberra. This paper uses emerging technology. I undertake post university study in the area of financial services. I study accounting in my spare time.

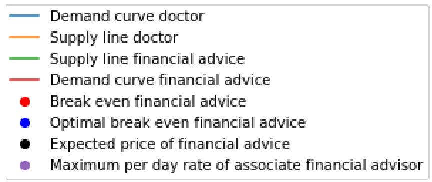
The only way to reduce financial advice is to increase supply to consumers having larger market monopoly. This is interpreted as large entities giving advice that use employees substandard to higher paying positions. They can also spread fixed costs. This will result in a loss of control. Having the nature of financial advice, is that most advisers run their own business, losing control anyway.

The nature of financial advice is that is given in high populated areas where there is a high income market subject to higher fees. Due to this living expenses are higher due to the advisers domestic costs.

Doctors charge $80 for intervals of around 10 minutes and are fully booked throughout the day. Given these assumptions doctors charge $480 an hour give or take. I use this as a widely accepted assumption as doctors often advertise their rate due to competition.

Figure 1.1: Supply and demand





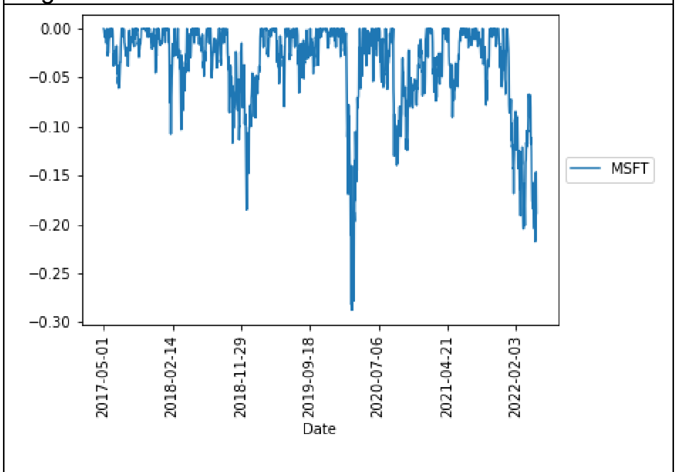
Optimum demand curve is based on high quality advice offered by an alternative industry.

Given this assumption to result in high quality advice. Assumptions are relaxed like maximum supply and demand in indicative industries. The advice cost is approximately around $2284.26 and $3119.51. If financial advisers charged like lawyers and the assumption the going hourly rate is $250 advice would cost $1875 per day. In terms of efficiency with the assumption of $550 [1] advice fee would require 287 new advice clients per year and be at an economical loss $550 - $527.61 = $22.39.

To give a client full service investment advice the adviser would have to broker the account. This is selection of individual assets and running the portfolio. This is a learned process that costs time and effort outside already time poor professional advisers. There is also the control aspect. A adviser with competencies in markets however doesn't have information all the time that is influencing markets, is complex due to multiple touch points. The other option is a managed fund that deal with investments in a more intricate way, a handful of portfolios.

To the point an adviser cannot manage 287 portfolios with high conviction with the resources and technology available to an individual adviser.

Figure 2.1: Drawdown Model



Source: Yahoo Finance. (2022).

Table 2.1: Microsoft loss sample

1 Australian Government |The Treasury. (March 2022). *'Quality of Advice Review Issues Paper'*.

16/3/2020	-0.14739
12/3/2020	-0.094838
27/2/2020	-0.070459
9/3/2020	-0.067773
3/9/2020	-0.061947
10/10/2018	-0.054338
8/9/2020	-0.054096
11/6/2020	-0.053698
24/10/2018	-0.053469
8/2/2018	-0.051334
28/10/2020	-0.049566
3/3/2020	-0.04792
27/3/2018	-0.045959

Source: Yahoo Finance. (2022).

The Value at Risk (VaR) model has limits. We can look at the drawdown, this tells us loss overtime which is a good estimate to value at risk which for Microsoft is estimated around -28.75% which would indicate to avoid loss, the portfolio include assets that aren't correlated to Microsoft to offset this loss of around 28.75% in portfolio holdings. This limits the loss of Microsoft. This is an inference. Who is really conscious about hereafter of Microsoft. Employees and directors of Microsoft? Someone who has read Microsoft's financial reports? Every individual has aspects outside their control, emotion, tolerance and new information as a stakeholder. We can try learn from the past but how much is influencing the memory of the data and results as the business progresses and grows.

Despite this education material is absent in areas of financial services. The lack of advice on managed funds is to extent that it is an issue in the industry. Education on how and why managed funds select asset portfolio weights is not apparent. Yes its part of the industry to have individual proprietary trading as a business. But the universities don't teach portfolio selection. It's part of everyday life with superannuation. But there is a grey area around how money is being invested. At University of Sydney schools a unit Investments and Portfolio Management (FINC3017) [2] with the assumed knowledge introductory statistics, calculus and microeconomics. The unit used excel which is a widely accepted application. The data analysis is good however using excel to select portfolio weights is just not what the industry is likely to use. I did use Bloomberg however portfolio selection is likely done through software that is coded. The internet is also useless in the area.

University of Canberra is even less technical in the area of portfolio selection, maybe they just gave up because it's a third or secondary tier industry. The university could turn around and say but that's for the industry to teach you and get experience. Well the issue there is there is very little experience for financial advisers to get outside the major cities where the financial hubs are. Most managed funds are small groups employees, you think of the American banks with individuals everywhere. So what do advisers do. They put their clients in market capitalisation indexes. The client pays $3,750 [3] for substandard advice for a simple product. Does market indexes have a place, yes they give the individual investor exposure to the market and asset class with less intervention from a person. I think the accessibility for higher wealth is an issue addressed with technology like the app CommSec [4] pocket but has the same risk profile as the asset class, as it is a product in the underlying asset class. This is not limited to a particular broker (Commsec) however some services are better then others and dealing with taxation and reporting to the Government is a key factor I look for in broker technology. This is why advice cost is high because the compliance is required but there is little due diligence, risk associated to different parties, and the product template for a Statement of Advice (SOA) is copied, this sort of advice definitely can accommodate a lower fee.

The issue is advisers are giving advice to investment funds without understanding how and why it works.

Some advisers have left the industry, rather than complying with new education or exam requirements. [5]

What is ethics? Is it reducing sales in conflict of interest with remuneration to the adviser. Is it putting the client in environmentally friendly and ethical investments. I don't know the answer. I think the adviser should earn the amount they deserve reducing commissions doesn't help the adviser and results in looking for alternatives ways to earn an income. That's at the cost of the client. I was able to get an education built into my degree at University of Canberra, the unit 'business ethics'. It wasn't situated around financial advice. It looked at ethics from a business standpoint. The point is corporate (social) responsibility. What is the adviser responsible for within the law.

What is poor advice? Is it if a court was to audit the advice, what are the limbs of that advice and was it to a standard that helped the client. In the ethics course we looked at 'means to an end'. I think this is just within the law and this is a 'means to an end'. Advisers have to look at the

2 University of Sydney. (2022). '*FINC3017: Investments and Portfolio Management*'. https://www.sydney.edu.au/units/FINC3017

3 Australian Government |The Treasury. (March 2022). *'Quality of Advice Review Issues Paper'*.

4 Commonwealth Securities Limited (Commsec). (2022).

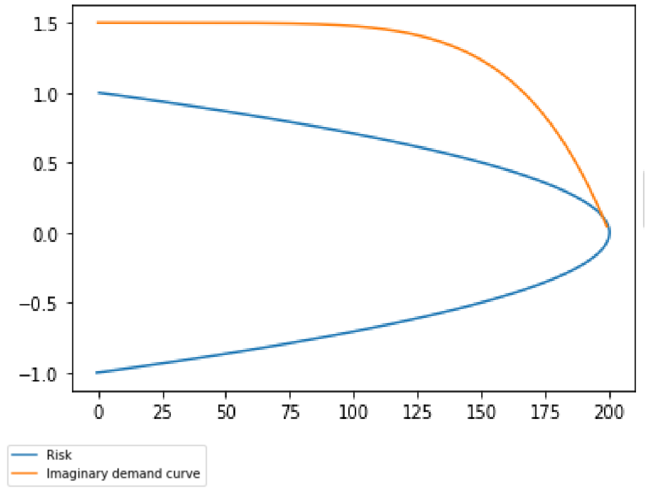
5 Australian Government |The Treasury. (March 2022). *'Quality of Advice Review Issues Paper'*.

economic cost which is different to responsibility. The issue with financial service is it deals with money. There is the incentive to control those capital flows for one's own incentive. In economics if a person is indifferent they look for the lowest cost alternative. I'd like to say social cost but often a advisers supply can't intersect with demand due both sides consumer and adviser. Due to indifference consumers are rational with what information they have or prefer lower cost/high returning options because the benefit isn't realised to the wealth of the customer. This is the situation with the Government's "Your Future, Your Super Performance Test" [6] which is a test conjunction to a benchmark [7] to "improve its efficiency, transparency and accountability". The issue is alternative assets with decreased social costs with lower returns are ignored. The actual application of pensions is to earn excess of inflation deterioration. I can only assume two reasons for Government regulation. Assumption i. It is uneconomical to earn a lower rate of return and retirement outcomes precede. Investors are expected to look outside of Superannuation to invest in alternative investments. Assumption ii. The less rational explanation is Government thinks investments are already decreasing social and economic costs at a higher rate of return incorporated into superannuation returns. I won't try to explain with depth environmental (any ecosystem in society) investments as standard behaviours. It's opinion that social cost isn't a function that is intersected through research to breakeven in society. Therefore capital is allocated appropriately to this index function not environmental investments.

I don't expect that corporates aren't trying to and succeeding in applying environmental investments (reducing society costs). I just think some advancements isn't at capacity or adopted for whatever reason. Cost and social restraints. But some of this is taken up by corporates and alternative investments. This is where alternative investment is missing in Government regulation.

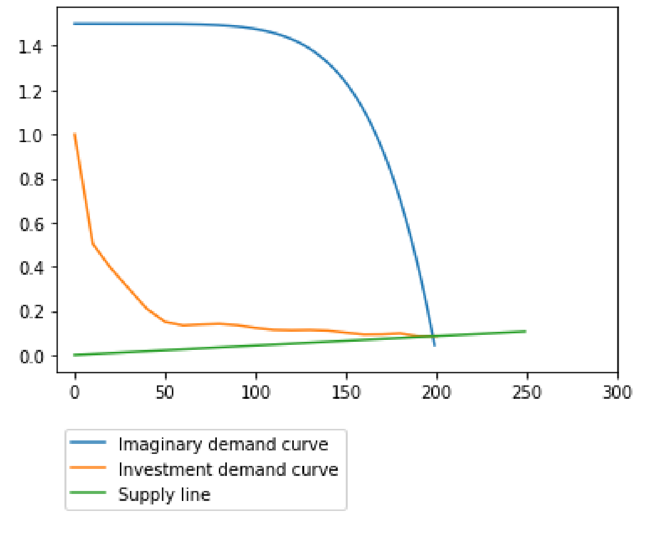
Ethical investments come with ideology to expectations. What a individuals expectation is different. Views are but religious to that expectation. This creates an imaginary demand curve. That isn't social cost and economical. The adviser is restricted to what is, and isn't.

Figure 3.1: imaginary demand curve



This illustration shows the risk trade off (convex). Investors not only earn returns they can lose. Individuals can have unrealistic expectations shown in the second demand curve.

Figure 3.2: The investment demand curve



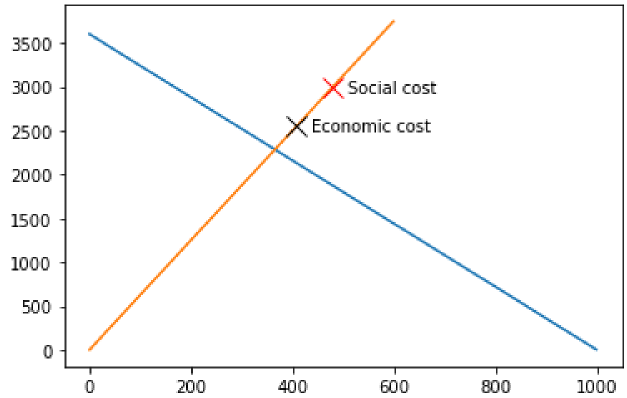
This uses assumptions not data. in this assumption the demand curve convexes in. The synthetic data returned 13.73% at 200 assets.

The imaginary demand curve occurs when it is irrational to expect the adviser to pay for one's views that are essentially outside the demand curve or undercutting the adviser to achieve one's goals. The adviser would face litigation for partaking. The imaginary demand curve may be met in the future but is unrealistic currently. This is different to forward thinking which contains risk that may payoff.

Figure 4.1: Economics of cost and social costs

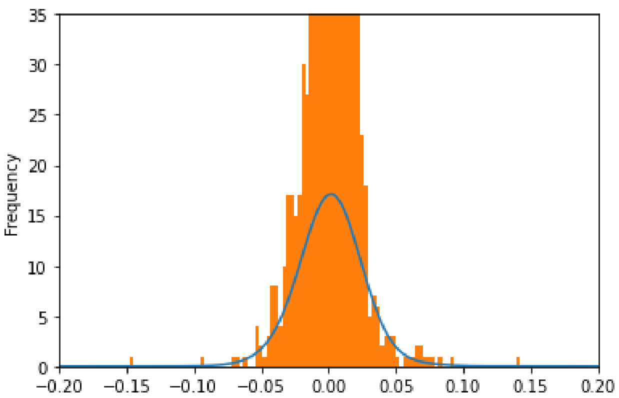
6 Australian Prudential Regulation Authority (APRA). (2022). *'Your Future, Your Super Performance Test'*.

7 *"The blended returns are calculated by APRA using end of reporting period index level values licensed from MSCI ("MSCI Data")."* There is not complete transparency as to index used but this was referenced. Australian Prudential Regulation Authority (APRA). (31 August 2021). *'Your Future, Your Super Performance Test – MySuper Performance Test results.XLSX'*.



Economic cost ie legal cost paying out what is expected by the court. This includes cost to the client and adviser given poor advice that is refunded. This cost is the advisers is out of pocket. They can pass it on but is not advised as its not unlawful but is poor business. Social cost is borne by the client, the adviser is already outside the supply and demand curve and isn't legally required or preference to pay for this. Why would adviser take a pay cut. The consumer is out of pocket due their expectations and risk payoff.

Figure 5.1: Microsoft distribution.



Source: Yahoo Finance. (2022).

This shows the return distribution unlike set parameters of the variables in other illustrations.

In my experience the diversification required is a limit. The risk tolerance is 10% therefore you hold 10 assets totalling 10% adjusting the intrinsic risk of the asset you invest in (a threshold). In consideration an asset always has the risk losing the investment going to 0 defaulting.

I was a financial adviser associate and was given a task. That task was time recorded using an accounting software timesheet. It took 3 hours and 45 minutes (3:45) to get to a point to give to the adviser. The research task was to look at any policies on record. Log into to company to see if the policy exists. Record the details of that policy. Record the policy into Iress. Forecast advice and accompany market research on the product in the best interests of the client. Download the policy documentation including the cost of that product (given prices are different overtime). The adviser uses that information to create a record of advice to attend and interact with the client. In this situation a SOA wasn't drafted with aspects of legal, company policy and ASIC regulation. However with this the billable hours are already $250 × 3:45 costing $937.50 that's not including the billable hours of the adviser at a higher rate.

Financial advice is a third tier industry. A first tier industry is banking, technology and health. Everyone wants it and it is a high income sector.

Figure 6.1: Goldman Sachs annual report

$ in millions	Year Ended December 2021	2020	2019
Consumer & Wealth Management			
Net revenues	**$ 7,470**	$ 5,996	$ 5,203
Provision for credit losses	**592**	758	423
Operating expenses	**6,294**	4,901	4,545
Pre-tax earnings	**$ 584**	$ 337	$ 235
Net earnings to common	**$ 427**	$ 216	$ 159
Average common equity	**$10,796**	$ 8,012	$ 6,292
Return on average common equity	**4.0%**	2.7%	2.5%

Source: The Goldman Sachs Group, Inc. And Subsidiaries. (2021). '*Annual Report*' pg. 67 Goldman Sachs 2021 Form 10-K.

I noticed that advice industry with the example of Goldman Sachs the profit is highly diluted I considered. The profit for the business was $21 billion. [8] The profit from financial advice sector was 2.01% ($427 million) of the business profit. You'd think that the Goldman Sachs business model is financial advice. This is an international brand. The Commonwealth Bank of Australia made $4.8 billion from retail banking services in 2021. [9] These are large sums of money to a standard but the profit is tiered under its peers in financial services. Some entities join wealth services (financial advice) with other revenue and don't breakdown the figure. Insignia Financial Ltd (IOOF) earned a profit of $20.1 million for financial advice.[10] Pinnacle Investment Management reported a profit $67 million. [11]

8 The Goldman Sachs Group, Inc. And Subsidiaries. (2021). 'Annual Report' pg. 67 Goldman Sachs 2021 Form 10-K.

9 Commonwealth Bank of Australia. (2021). '2021 annual report' pg 44.

10 Insignia Financial Ltd. (2021). *'Annual report'* pg. 40.

11 Pinnacle Investment Management Group Limited. (2021). *'Annual report'* pg. 65.

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