Association of Financial Advisers

Royal Commission failed to Understand the Value of Ongoing Financial Advice

(By Phil Anderson – General Manager, Policy and Professionalism at the AFA)

Despite all the challenges that the financial advice profession have faced over the last decade, it was always accepted that there were some great financial advisers who delivered excellent results for their clients. Whilst even the greatest detractors argued that the issue was more than just a few rogues, it was still accepted that there were many highly qualified advisers who were very ethical and very client focussed.

The Royal Commission, it seems is challenging this. There is no acknowledgement that there are many good advisers or the benefits that they deliver for their clients. There is no acknowledgement of the relatively small number of complaints received by ASIC and External Dispute Resolution schemes. They don't appear to have spoken to either good advisers or their clients and it was not part of the terms of reference. It seems that they only looked at where things went wrong. In our December 2018 further submission, we offered to introduce them to some good advisers so that they could develop a genuine balanced understanding of the value of financial advice. Like much of what we told them and suggested, it was not taken up.

Their opinion of the financial advice profession is disturbing, as illustrated on page 120:

"The industry has moved from scandal to scandal, causing financial harm to clients, and damaging public confidence in the value of financial advice."

The value of Financial Advice

Financial Advice delivers significant benefits to clients. It is therefore a huge disappointment that the recommendations are based entirely on a response to the examples of poor advice.

We went to particular lengths, in many of our submissions to talk about the financial, emotional and behavioural benefits of financial advice, however it appears that this fell on deaf ears. They just seem to have little idea what a good adviser does for their clients or understand the impact that they can have on the financial and emotional outcomes for their clients.

This lack of understanding is highlighted in the following statement about the value of ongoing advice on page 143 of the report:

"Absent extraordinary external events or radical change in the client's personal position, it would be very easy to provide the service {annual review} with little time and little effort. And, as pointed out above, the less work that is done, the greater the financial advantage to the adviser."

There are also repeated references to the "invisibility" of ongoing financial advice fees where they are paid from a product account, and a misunderstanding about what product providers require to facilitate a payment to an adviser, as demonstrated in the following statement:

"I noted in the Interim Report that platform operators have routinely deducted, and continue to deduct, ongoing service fees from clients' accounts and have remitted, and continue to remit, the fees to advice licensees <u>without having any authority beyond the licensee's claim to be entitled to payment.</u>"

This suggests that the Royal Commission did not understand and has not reviewed the application forms in a Product Disclosure Statement (PDS) or seen application forms where clients sign to demonstrate their approval for the payment of ongoing advice fees from their accounts. We explained the authorisation contained in the application form in our Interim Report submission, however, once again this was ignored.

The final report also includes a comment that suggests disapproval of the treatment of client books as tradeable assets, which seems unreasonable, as financial advisers should be able to realise the value of the businesses that they have built, like any other small business owner.

The Value of Ongoing Financial Advice

The AFA and CoreData undertook research in 2018 on the value of financial advice. The research highlighted that these benefits can include more income in retirement, lower interest bills, lower tax bills and demonstrably enhanced net wealth at key milestones, and in the face of unexpected life events. The research identified benefits in three areas:

- Financial benefits,
- Emotional benefits, and
- Behavioural benefits.

In terms of emotional benefits, this research indicates clear and significant emotional benefits emerging from the advice experience. A major element of the advice value proposition relates to peace of mind and greater confidence in managing finances. 82.7% of clients who've received advice say they are very well or reasonably well prepared for retirement, compared to just 33.0% of non-advised clients. 79.4% of participants in the research, stated that an advice relationship contributes to greater peace of mind. And with that peace of mind comes clarity, and an ability to better manage finances. There is a direct link between financial advice and happiness. Advised clients are better positioned to respond to the numerous financial stresses facing all Australians. The research shows that 23.5% of advised clients worry about money at least weekly compared to 47.2% of unadvised clients.

Some of the benefits of an ongoing financial advice service arrangement include:

- Tracking progress against client goals and holding clients accountable for the achievement of those goals.
- Adjusting a current financial plan in line with altered goals and lifestyle changes.
- Assisting clients with improving financial decision making and behaviours, including controlling expenditure, debt management and maintaining good savings habits.
- Enhanced financial awareness and literacy.
- Reviewing and adjusting the client's risk profile to ensure the current asset allocation of the investments are appropriate to the client's changing needs and objectives.
- Review of investment asset allocation and performance, including to bring the actual asset allocation back in line with the target asset allocation and the strategy.
- Review and update of beneficiary nominations and ownership structures of assets to ensure a client's estate intentions are adhered to in an appropriate way.
- Identifying other issues such as the need to review wills, powers of attorney, the need for tax planning or helping clients with elderly parents with respect to strategies for Aged Care.
- Ensuring that insurance arrangements continue to reflect client needs and changes in personal circumstances.
- Counselling and coaching clients through life's journey including marriage breakdowns, births, deaths, retirement, redundancy and other significant events.

Ongoing service ensures clients understand the discipline of maintaining, reviewing and sticking to a plan in much the same way as a coach. Financial advisers help to hold clients accountable to their plans.

Ongoing Superannuation Advice

The Commissioner has more to say about the value of ongoing advice and the payment of ongoing advice fees from superannuation products on page 241:

"Perhaps a superannuation member invested through a platform would benefit – or believe they would benefit – from ongoing financial advice in respect of their superannuation investments. But such benefits would be relatively modest, and would accrue to relatively few members. As I said at the outset, the invisibility of ongoing advice fees was a key element in the charging of fees for no service. As long as ongoing service fees are permitted, some risk of members being charged fees for no service will endure. It may be that the benefits of eliminating that risk, by prohibiting ongoing service fees from superannuation altogether, outweigh any limited benefits these arrangements may provide.

I acknowledge the submissions from some entities that prohibiting ongoing advice fees would reduce access to financial advice for some (or many) Australians. But if the recipient will not pay the fee that the adviser charges except out of a superannuation account, what does that say about the value to the recipient of the advice that is given? Does it show that the taxation treatment of superannuation contributions and benefits are driving the matter? And if they are, what does that reveal about how the recipient values the advice that is given?

Absent some convincing explanation from those who seek to maintain a system of charging fees against superannuation investments, the most likely conclusion must be that what is proffered by the adviser is not seen by the recipient as warranting the fee the adviser charges. And if that is right, the proposition that needed advice will not be given loses most if not all of its force. "

The suggestion that clients, who choose to pay for the advice out of their superannuation fund indicates that they do not value the advice, is simply disrespectful to the many Australians who are looking to do the best that they can, but struggle to afford all the things that they need to spend their money on. Managing cashflow is a critical issue for many everyday Australian clients. Not everyone is on the salary of a judge or a high powered lawyer, with free cashflow to pay for financial advice. The suggestion that it is the tax arrangements inside super that may also distort the outcome is also staggering. Financial advisers work hard to get the best outcomes for their clients, and this includes ensuring that the best structures are utilised, and the best tax outcome is achieved. In any case, superannuation is the biggest savings vehicle for most Australians and accordingly financial advice is critical to maximising client outcomes.

We accept that there is potentially a genuine issue with respect to the application of the sole purpose test and ensuring that all advice that is paid for out of a super fund is for the benefit of the member's retirement outcome or other complying purpose. APRA provide some high level guidance on this, however it would seem that more is required. Nonetheless, this is a secondary issue.

Intra-fund Advice

In terms of Intra-fund advice, the Commissioner did not look at this and only offered the following comment:

"Finally, nothing I have said above (including in respect of MySuper) relates to what is known as 'intra-fund advice': the provision of advice that is not personal advice, to members of a particular fund about their interest in that fund, where the cost of the advice is charged collectively to members of the fund in accordance with the SIS Act. It was not suggested that any misconduct arose from such arrangements and I say nothing about them."

Industry Super Australia asked for much in this process, including the removal of grandfathered commissions, life insurance commissions, non-monetary benefits, and ongoing fees from superannuation accounts (or otherwise move to annual renewal). One thing that they called for to be retained was intra-fund advice, and that is exactly what they got (again). We are not arguing for the banning of intra-fund advice, however we do appreciate that it has the ultimate conflict of interest in that it can only involve a recommendation with respect to the fund that the adviser works for. ASIC has acknowledged that they have not yet looked at industry fund advice, so it is not surprising that there were no issues highlighted at this stage. It is interesting to hear that following the finalisation of the Royal Commission, the industry fund movement is now pushing for a broader definition of intra-fund advice. One further point to note on this statement, is that the Commissioner is wrong again, and intra-fund advice does include personal advice (ASIC Information Sheet 168).

The Logic for an Annual Renewal and Notice to Product Providers

The recommendation to have an annual opt-in is based upon this flawed view that there is no value in ongoing advice. I can only wonder how different this might have been if they took the time to talk to the many happy and informed clients of good advisers. That is not to say that some refinements might be required, to ensure that the opt-in and fee disclosure model is working effectively, however what is being proposed will become a real cost impediment and a major obstacle for those clients who have reduced needs and limited capacity to pay. The impact will be much less for those who are high touch clients and see their adviser frequently. It does not mean that those who see their adviser face to face less frequently, do not get value out of their ongoing service arrangement.

The rationale for the provision of annual authorisation notices to product providers is based upon a lack of understanding of product application forms and client consents. Doing this every year is totally unnecessary and costly. It might be that it is not appropriate to rely for an extended period of time on the original signed application form, and as we suggested in our submission in response to the Interim Report, this could be renewed every five years.

Recommendation 2.1 on Annual Renewal is based upon a flawed view of the value of financial advice and a lack of understanding of client consent. There is nothing wrong with biennial renewal, which provides the right balance between client confirmation and administrative efficiency. This of course is supplemented by the fee disclosure in the annual Fee Disclosure Statement and regular product statements. The suggestion of 'invisibility' of fees is both unreasonable and unfair. An adviser service agreement for 12 months or less is not defined as an ongoing fee arrangement and would therefore not require an FDS or Opt-in. If this annual renewal recommendation is implemented, then putting in place new 12 month arrangements each year, may be the best solution available.

Collateral Damage

All advisers should be concerned about the way financial advice has been described and treated in the final report, even those who think the Royal Commission is a great opportunity to deliver fundamental change and help make financial advice a genuine profession.

There can be no doubt that what the Royal Commission has said about financial advice, both fair and unfair will have a long term impact. Care Super has recently rolled out a bus stop advertisement – "We don't think charging fees for no service is the basis for a stable relationship." We can expect the detractors of financial advice to continue to throw these lines out there to the detriment of all financial advisers, including those most prepared for the future and already delivering great service.