



Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 619 921
PO Box Q279
Queen Victoria Building NSW 1230
T 02 9267 4003 F 02 9267 5003
Member Freecall: 1800 656 009
www.afa.asn.au

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Treasury
Langton Cres
Parkes ACT 2600

AFA Submission – Pre-Budget 2021/22

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a code of ethical conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

The AFA welcomes the opportunity to provide Treasury with a pre-budget submission. The COVID19 crisis has highlighted the importance of financial advice for Australians through the value it delivers during times of adversity and financial uncertainty. During 2020 there was an increased awareness within the broader financial services industry and the community that a never-ending series of reforms has materially increased the cost of financial advice and significantly reduced access to advice for everyday Australians. It is clear that this outcome is now increasingly understood by the Government and ASIC. The critical thing is to work out what can and should be done to reverse this disturbing trend in access and affordability.

We understand that the Government is seeking to reduce the costs of doing business and to increase employment in small business. The reality is very different in financial advice, where costs have been escalating rapidly and employment has fallen drastically.

Contrary to the largely negative perception of financial advisers, that has been promoted over recent years through media and other self-interested stakeholder groups, and influenced in many ways by a Royal Commission that focussed almost exclusively on the wrong-doing of some large institutions, existing financial advice clients highly value their financial adviser relationship and believe that they are getting much more back in return, when compared with what it costs. This view has been enhanced by a large-scale research project recently completed by Core Data for IOOF. The sceptical view put forward by the Banking Royal Commission on the value of financial advice to consumers has been dismissed by the many

happy consumers of financial advice in this study. We would therefore argue that the Government should balance what seems to be the prevailing view put forward by uninformed detractors with evidence-based feedback from actual existing clients.

In fact, the Core Data research reveals that the clients of IOOF advisers:

- Enjoy a sound understanding of the value of advice and are able to identify key elements of the advice offer that they recognise as having a value that exceeds the cost.
- Highly regard and trust their advisers, demonstrate a significant level of loyalty and are strong net promoters.
- Exhibit a high level of self-assessed financial well-being, reflected in preparedness for retirement, a low tendency to worry about money and minimal impact of financial concern over their personal life and health.
- Find their journey through the advice process has provided them the ability to strongly rely on their financial adviser for guidance, a clear understanding of the areas of their life in which advice has helped them, greater confidence setting and achieving goals as well as a realistic understanding of the cost.
- Are fundamentally better off than unadvised consumers in a range of both tangible and less tangible measures regardless of gender, age and wealth.

Background - Decline in the Number of Financial Advisers

The decline in the number of financial advisers limits the accessibility of advice for Australian consumers, and is only going to get worse over the next few years without strong actions from Government.

At the commencement of the new Professional Standards/Financial Adviser Standards and Ethics Authority (FASEA) regime in January 2019, there was a total of over 28,800 financial advisers on the Financial Adviser Register (FAR). Over the last two years, this number has declined to around 21,200 in January 2021, representing a reduction of approximately 7,600. The number of Provisional Financial Advisers recorded on the Financial Adviser Register is only 58, which highlights the lack of new advisers coming into the financial advice sector. These changes to the market and the rapid exit of experienced financial advisers is due to a range of factors including the new exam and education standard (that fails to recognise experience), the increasing and overwhelming compliance requirements and resultant increasing costs and an overall decline in the economics of financial advice.

In December 2020, FASEA announced the results of the November 2020 financial adviser exam. There are now 11,241 financial advisers who have passed the FASEA exam. This leaves around 10,000 existing registered financial advisers who still need to pass the exam before the deadline at the end of 2021. It seems inevitable that during the course of 2021 there will be a further significant decline in the number of financial advisers and no foreseeable increase in new advisers, making access to financial advice much more difficult.

AFA Recommendation

In this submission, we have focussed our attention upon a few key recommendations directly related to financial advice and increasing access to advice and the affordability of financial advice.

Tax Deductibility of Financial Advice

At present the cost of ongoing financial advice, that is related to the earning of ongoing investment income, is tax deductible to consumers. The cost of initial financial advice is not tax deductible. Premiums for Income Protection insurance that cover the commissions paid to financial advisers are also tax deductible to many Australians, however, premiums for other forms of life insurance are not tax deductible, so the cost of advice, that is built into these premiums (through commissions) is also not tax deductible.

The cost of advice that is charged to a superannuation fund, or life insurance premiums paid by a superannuation fund, is deductible to the fund at the rate of 15%.

In the context of the rapidly rising cost of financial advice, and the fact that cost is a significant detractor in people seeking advice, we recommend that the Government extends the current tax deductions to include up-front advice and the cost of advice on life insurance. Access to tax deductions at the marginal tax rate will assist in reducing the cost of financial advice and therefore make it more affordable.

This deduction should not be seen as a revenue reduction to the Government, but more an investment into creating awareness and encouraging Australians to take financial control of their own future and in doing so, reduce the short and long term burden on the Government.

We understand that the Government might want to put a cap on this tax deduction for upfront advice as a control measure and we would support something that covers the majority of the mass market (i.e. fees of up to \$5,000).

Addressing the Excessive Increase in the ASIC Funding Levy

The total cost of ASIC's oversight of financial advisers who provide personal advice to retail clients on relevant financial products has increased from \$26 million in 2017/18 to \$33 million in 2018/19, and then to \$56.2 million in 2019/20. The cost that is passed on to financial advisers has increased from \$934 per adviser for 2017/18 to \$1,134 in 2018/19 and then a proposed \$2,426 for 2019/20. This is an increase of 160% in just a two- year period. Given that the full costs are being allocated across all financial advisers on the FAR, and the number of registered advisers is progressively declining, the costs can only continue to increase, unless the Government takes action.

We called for relief on the ASIC Funding Levy during the COVID 19 crisis, and in December 2020, when we discovered that the ASIC spend on financial advisers had mysteriously increased from \$40.1m to \$56.2m, we called on the Minister and ASIC to explain what had happened and to provide relief. We observe that more is spent by ASIC on the oversight of financial advice than any other regulated community that ASIC oversees and question the rationale for this, particularly when the number of financial advisers is declining so rapidly and at the same time the professional standards are being increased.

We seek some clarity and transparency so as to understand what has driven this huge increase, however we presume that it could be the funding of ASIC enforcement action against some of the large institutions that were named in the Royal Commission. If this is the case, then we strongly object to the proposition that small business financial advisers should be picking up the cost of court action against large institutions, many of whom have chosen to either exit the financial advice market or substantially scale back their advice businesses. Many of the advisers have no choice but to pass on any increases in regulatory fees to their clients, which continues to increase the cost of advice and places advice out of the reach of everyday consumers. Where small businesses are picking up the cost for large institutions, this would surely suggest that the funding model is flawed.

We call on the Government to provide relief to financial advisers for the 2019/20 and 2020/21 years and to review the model for future years so a reasonable and sustainable levy can be maintained. As a minimum, the funding levy should be pegged to the 2018/19 level. Whatever the Banking Royal Commission revealed about these large institutions, it should not result in ASIC being able to exponentially increase their costs or to result in an ongoing disadvantage to small business financial advisers and as a result their clients. In the context of this surprise increase in the ASIC spend on financial advisers, we believe that there needs to be a cap and changes to the framework to deliver greater transparency.

Creating Growth and Employment Through Government Support for Professional Year Students

As we have highlighted above, at present there are only 58 Provisional Financial Advisers registered on the FAR. This is the number of new financial advisers in the second half of their Professional Year, who have passed the FASEA exam. In an environment where 7,600 financial advisers have left the financial advice profession since December 2018, more needs to be done to ensure that they are being replaced by new advisers and to encourage more employment and growth in small business and more jobs for students. There are a range of factors in play here, including the following:

- The Professional Standards/FASEA reforms and the increased requirements for new entrants to the financial advice profession.
- The reputational damage and discouragement from entering the financial advice profession as a result of the negative slant and related media coverage from the Banking Royal Commission.
- The exit, or significant downsizing of the large institutionally owned licensees, who were previously an important sector of the market for the development and support of new entrants.
- The significant cost involved in bringing a new entrant into financial advice, including 100 hours of structured training and 1500 hours of on-the-job training, when their contribution to the business is limited and the employer would need to compete with other employers to attract candidates.

The majority of financial advice practices are small businesses who are currently under tremendous financial strain, however with the right incentive, they could grow their businesses and provide valuable employment opportunities to students after many years of study and set them up for a meaningful career.

We therefore recommend that the Government provides an incentive for financial advice practices to employ Professional Year students. This could work as a wage subsidy, as has been the case in the COVID 19 relief measures. A \$10,000 subsidy would make a material difference in encouraging financial advice practices to appoint Professional Year candidates.

Fully Leverage the Single Disciplinary Body Establishment

On 9 December 2020, The Treasurer and the Assistant Minister for Superannuation, Financial Services and Financial Technology issued a media release (Strengthening and streamlining oversight of the financial advice sector), announcing the establishment of a single disciplinary body for financial advisers and the winding up of FASEA. We support this announcement as financial advice is subject to excessive and duplicative regulatory oversight. There are three main regulators of financial advice – ASIC, FASEA and the TPB. This has resulted in multiple different sets of rules, different Codes of Ethics/Conduct, multiple disciplinary models and importantly multiple fees. Whilst the announcement did not refer to the TPB, we understand that they would be part of this rationalisation. To establish regulatory simplicity, efficiency and cost effectiveness across the sector, the AFA supports one regulator, one set of rules, one Code, one disciplinary system and one affordable fee.

We recommend to the Government to fully leverage this Single Disciplinary Body rationalisation opportunity to ensure that in this exercise the regulatory regime for financial advice is simplified and that the regulatory oversight cost is reduced and the fees paid by financial advisers can decline. It is our view that this is an important immediate opportunity to consider a range of options to simplify financial advice and to remove non-value adding activity and steps that have arisen over time due to regulatory overlap and excessive compliance standards. We encourage the Government to consider a broader set of objectives in achieving this important reform.

Comprehensive Review of Financial Advice

We are very much aware of the recent project that ASIC have launched and the consultation process that they have undertaken in Consultation Paper 332 on 'Promoting access to affordable advice for consumers', however, we believe that a more comprehensive exercise will need to be undertaken to consider the full

range of options to reduce the cost of financial advice and the regulatory inefficiency in the provision of financial advice and related services. The Government is committed to red tape reduction and have devoted resources to achieve this objective. Financial advice is an important sector and one where there is significant opportunity for re-engineering and establishing a modern platform that considers all stakeholders and provides a strong pathway for a sustainable future. We encourage the Government to consider the establishment of a comprehensive review of the financial advice regulatory regime and to consider the impediments to the provision of efficient cost effective, affordable advice and to provide budget for this exercise.

Concluding Comments

This is a very important time for financial advice. Financial adviser numbers have been declining at a rapid rate, there is a fundamental lack of new entrants and the cost to provide financial advice is rapidly increasing. Without action by the Government, access to affordable financial advice is at risk for everyday Australians. The overlay of the COVID-19 pandemic has only served to increase focus on the potential of financial advice to benefit everyday Australians, both tangibly and intangibly through financial wellbeing and preparedness for all stages of life, including retirement. Surely now is the time to transform this important service to the community, slow the rate of decline and build a valued, respected and sustainable profession that adds value to the community and contributes as a vibrant and growing sector of the economy.

We thank you for the opportunity to provide a pre-budget submission and would be happy to discuss these recommendations further, or to provide additional information if required. Please contact us on (02) 9267 4003 if you have any questions about this submission.

Yours sincerely,



Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd