IGNITION

Australia Insights

Compliance myths about digital advice

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Ignition is a leading global advice technology specialist for financial institutions seeking to help more customers access financial advice in a fast and scalable way.

We help our clients combine the power of digital intelligence with a human touch to enable smarter, more flexible and more secure advice delivery.

We partner with banks and wealth managers worldwide. Our SaaS platform integrates seamlessly into existing systems enabling our clients to deliver a frictionless, customer-centric experience that brings a customer and adviser together into a single advice workflow.

For more details on how we can help you build your advice vision and enable more customers to make better financial decisions, visit **discoverignition.com**

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Three compliance myths institutions believe about digital advice

Regulation and reluctance is stopping Australia from embracing digital advice.

If you ask any financial services executive what their most significant burden is when delivering financial advice, the answer, without doubt, is risk and compliance.

Financial advice has been under increasing compliance pressure since the Best Interests Duty was introduced in 2012, culminating in the 2018 Hayne Royal Commission and ASIC's advice look-back. While establishing greater compliance was driven by the desire to increase industry standards and deliver better quality advice, it has caused significant time and cost issues for advisers and institutions that provide personal advice.

This has contributed to Australia's large financial institutions either selling or reducing their financial advice businesses. The number of financial advisers is currently c.15% below the long term average. Research from the Australian Financial Advisers Wellbeing Report 2021 shows that 40% of the 700 financial advisers surveyed are considering leaving the industry. It points out that, "administration and compliance is nearly 30% of all work tasks."

The additional hours it now takes to confidently meet current compliance requirements have seen advice fees rocket 28% in the past two years[1]. The knock-on effect is that financial advice is now more expensive and less available despite the near-universal agreement that it needs to be less expensive and more available.

So how can the industry make advice available to more customers at a lower cost and profitable for the institutions providing it? If the answer is scale, then how does the industry achieve scale compliantly when it is already struggling under the weight of regulation? We believe one of the answers is digital advice. And we believe it is well and truly possible right now within the letter of the law, despite the perception that laws need to change for it to be feasible.

Until now, institutions have been focused on how best to operate the traditional face-to-face model and extract whatever efficiencies they can. However, we believe now is the time for forward thinking that considers how technology can fundamentally shift the economics of advice.

We also understand that providing single issue personal advice via a digital solution in Australia is largely unknown. Institutions are aware there are rules and obligations but are not entirely sure how to successfully navigate them. While our European counterparts are well and truly deployed with digital advice solutions, we've lacked a solid front-runner to lead the way. But in reality there is a clear, logical and well-guided path to delivering digital advice compliantly.

In the following, we dispel three myths about providing digital financial advice compliantly. We lay out the evidence as to how ASIC encourages digital financial advice, how it has allowed for institutions to provide advice on their own products, and most importantly, how a smart digital solution, combining robo with a human touch, can satisfy the Best Interests Duty (BID).

Myth One: ASIC is not supportive of digital financial advice solutions

If ASIC were genuinely supportive, why haven't they made it easier for businesses to deliver? Why does scaled or single issue advice, which digital solutions are best-suited to solve for, have significant red tape and uncertainty associated with it? Why is it rarely encouraged, and in some cases, entirely banned by advice licensees? Is it because of the perceived significant challenges in supervising and monitoring the nuances of single issue advice? Is it just easier and safer to insist on comprehensive advice despite the obvious efficiency impacts?

We also see the failures of those who have previously tried. For example, robo-advice provider Lime FS Pty Ltd attempted to deliver automated advice using a proprietary algorithm. They shut down in 2019 after the corporate regulator raised concerns about the quality of advice generated by the online tools and Lime FS's ability to monitor the advice[2] But the founders said it was "overly challenging to provide holistic digital advice within the constraints of the existing regulatory framework."

Instead of expanding personal advice services, institutions have tended to gravitate towards general advice to engage customers. But the dependency on the general advice principle, while prevalent in the industry, is disliked by the regulator. In February 2021, The High Court ruled in ASIC's favour in a dispute with Westpac[3] over their provision of 'personal advice' under the guise of 'general advice' to some of their customers.

Events like these have embedded the idea that digital personal financial advice just can't be done as it stands today.

Truth: It is a fact that scaled advice is encouraged by ASIC and permitted by law.[4]

ASIC has publicly acknowledged that consumers want improved access to affordable, quality advice and that those who regularly access advice make better financial decisions over their lifetime[5]. In November 2020, ASIC renewed its efforts to promote access to advice, commencing a consultation on the impediments to providing affordable advice, including limited advice.[6]

Ignition's comprehensive input into FinTech Australia's submission to ASIC Consultation Paper 332: Promoting access to affordable advice for consumers, stressed that technology provides scale and efficiency that would allow the provision of advice to many more clients at the time they need it, in the way they prefer it, and at a cost that ensures they perceive real value for money. Traditional advice models, dominated by face to face client interactions simply cannot achieve the scale and efficiency of digital advice models.

The regulator has also recognised that people do not necessarily want or need to deal with all their potential financial goals simultaneously or continuously. Research shows that people tend to get or consider getting financial advice due to specific triggers such as buying a house, starting a family, receiving an inheritance or retiring.[7] And more than 50% of consumers across all age groups prefer receiving piece-by-piece or a do-it-yourself advice service.[8]

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[1] https://www.smh.com.au/money/planning-and-budgeting/dramatic-rise-in-advice-fees-as-planner-numbers-dive-20210129-p56xsb.html
[2] https://www.moneymanagement.com.au/news/financial-planning/asic-moves-result-robo-advice-tools-shut-down
[3] https://www.westpac.com.au/about-westpac/media/media-releases/2021/3-february/
[4] ASIC Regulatory Guide 244: *Giving information, general advice and scaled advice* - Table 1
[5] ASIC Report 224 *Access to financial advice in Australia* published in 2010 *and* in the *Nov 2020* Consultation Paper 332: *Promoting access to affordable advice for consumers*
[6] ASIC Consultation Paper 332: *Promoting access to affordable advice for consumers* (Nov 2020)
[7] ASIC Regulatory Guide 175: *Licensing: Financial product advisers – Conduct and disclosure* and Report 639: *Financial advice by superannuation funds.*
[8] ASIC Report 224 *Access to financial advice in Australia.* This was reaffirmed in 2019 by Investment Trends research which reported that 38% of surveyed participants who were potential

Many institutions across Europe, the UK and the US have already evolved their digital advice service into a hybrid version. They now offer scaled advice with the option to engage a human adviser to support or drive the advice experience, or where a comprehensive need is identified. We believe this has been fundamental to their success in meeting both the customer need and the regulator's requirements[9].

ASIC has already provided considerable guidance on how to provide advice on one or less than a full range of issues and that guidance is appropriate whether the solution is human or digital. They acknowledge that all financial advice is scaled to some extent, being less or more comprehensive on the spectra of personalisation, complexity and comprehensiveness.[10]

The same rules apply to all personal advice on a particular topic, whether it is comprehensive or limited in scope.

However, what must be done to meet the legal requirements, including the best interests duty and related obligations, can be 'scaled up' or 'scaled down' depending on the nature of the advice.[11]

So it is clear that ASIC supports single issue personal advice, regardless of whether it's a human or digital solution. They recognise Australians' need and desire for it and have provided the relevant guidance to enable institutions to deliver it.

financial planner clients indicated that they preferred piece-by-piece advice models (including face-to-face, phone and online advice services). NB The research was predominantly undertaken in the context of superannuation and investment advice, but the findings are also true for life risk advice.
[9] Reimagining Financial Advice, Altus, 2021 Pg 21 & Pg 23
[10] ASIC Regulatory Guide 244: *Giving information, general advice and scaled advice* - Table 1
[11] ASIC Regulatory Guide 244: *Giving information, general advice and scaled advice,* at para 54, 58-59

Myth Two: Institutions are not able to compliantly recommend their own products to their customers.

Since vertical integration entered the spotlight during the 2018 Hayne Royal Commission, institutions recommending their products to their customers has been seen as a no-go, or at best to be approached with great caution. Concerns about conflicts of interest, especially where customers are advised to purchase a new product or add to an existing product, have been raised as barriers to ensuring those customers receive advice in their best interests.

Some advice licensees believe they are required to have a broad-based APL, including in circumstances where they would prefer to, and do, only advise on in-house products. This seems to arise out of the second safe harbour test,[12] which requires advisers to conduct a reasonable investigation into the financial products that might achieve the objectives and meet the customer's needs.

The belief is not correct for all circumstances. It is an example of the current widespread confusion and concern over ASIC's position on how institutions can provide personal advice on their own products. It has led vertically integrated businesses into unnecessary over-compliance.

Truth: Institutions can confidently deliver single issue personal advice on their own products.

ASIC has issued guidance[13] that product providers can reliably follow, in tandem with the appropriate risks and controls, to deliver single issue personal advice on their own products.

The 'scope of advice must be understood and agreed' obligation is different for product providers who offer personal advice on their own products, particularly when provided digitally. This is because the scope of the advice offered is necessarily constrained by the products and services being provided and the nature and capability of the digital service.

Digital advice services[14] must demonstrate transparency about what services the digital tool does and does not provide[15]. They need to demonstrate that the customer actively understands whether the advice they seek is within the scope of what is being offered. Key concepts, risks, benefits, limitations and potential implications must be provided throughout the process, all presented in a customer-friendly way.

The regulator also states that APLs can be limited and may be restricted to a class of product[16] or in-house products.[17] How can this translate into a digital advice journey? The customer would answer a series of questions. If the algorithm identifies no suitable product within the providers' range, the customer is triaged out of the advice process.

ASIC also suggests benchmarking products to establish their competitiveness on key criteria such as features, fees and risks. The benchmarking must be reasonably representative of the market for similar products that are offered by a variety of different issuers.[18]

Vertically integrated advice and product businesses need robust systems and processes that ensure their products are only recommended to customers with a defined set of attributes and that the products they offer are competitive when benchmarked. Verifying the attributes by an independent financial services professional would assist in ensuring they are objective and form a reasonable basis for a product recommendation.[19]

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[12] s961B(2). See also ASIC Regulatory Guide 175: *Licensing: Financial product advisers – Conduct and disclosure* and ASIC Report 639: *Financial advice by superannuation funds,* at para 191, tip 40

[13] derived from ASIC's generic guidance on the best interests duty and scaled advice, incorporating its occasional references to advice on in-house products and limited APLs and digital advice, all contextualised for single issue advice on in-house products.

[14] ASIC Regulatory Guide 255 Providing digital financial product advice to retail clients, at para 96 -102. The digital advice scenario included in this guidance is particularly useful. These steps will also ensure compliance with FASEA Code of Ethics Standard 5, which requires an adviser to have reasonable grounds to be satisfied that the customer understands the advice they have been given, and Standard 3, which requires the adviser to avoid (including through appropriate management arrangements) actual conflicts between the customer's interests and the adviser or product providers' own interests

[15] This assists to ensure compliance with FASEA Code of Ethics Standard 4 which requires an adviser to only act for a client with their free, prior and informed consent

[16] A class of financial product is, in effect, the type of product, for example, life risk insurance, managed investment schemes and basic deposit products are all classes of financial product. Classes can also be more granular, e.g. term life, income protection and trauma insurance are also classes of financial product.

[17] ASIC Regulatory Guide 175: *Licensing: Financial product advisers – Conduct and disclosure,* at para 403(b)

[18] ASIC Regulatory Guide 175: *Licensing: Financial product advisers – Conduct and disclosure,* at para 403(b)

[19] This is analogous to the requirements of the Design & Distribution Obligations that will commence in Part 7.8A Corporations Act 2001 (Cth) from 2021 which will require product issuers to design financial products that are likely to be consistent with the likely objectives, financial situation and needs of the consumers for whom they are intended, and distributors must take 'reasonable steps' to distribute financial products only to the target market.

Spencer wants to purchase trauma insurance. He starts a digital advice journey with his bank. When answering questions about his circumstances, he indicates it's important he is insured against a particular type of trauma (e.g. cancer) because of his family history. The algorithm identifies that out of the available product set, there are none that scored in the top quartile of benchmarked competitor products with regard to cancer definitions. He is shown a message saying no suitable product can be recommended for him and he is triaged to a human adviser.

ASIC's guidance for product providers delivering single issue personal advice on their own products via a digital solution is clear. It should provide confidence to institutions that it is within the law and allows them to meet the growing need for advice.

Myth Three: How does digital advice meet Best Interests Duty obligations?

The industry uses the terms robo-advice and digital advice interchangeably, and it's widely believed neither can successfully satisfy Best Interests Duty (BID). How could it? Human advisers frequently struggle to jump through all the hoops; how can it be feasible for an algorithm to get it right every time when clients are too diverse, and their needs are too wide-ranging?

When we think about our industry's history in this area, we think specifically about robo-investing. A customer starts an online journey with an amount of money to invest. They answer some fact-find questions and the algorithm suggests a product for them to invest in.

It's hard to align this solution with the complexities of personal financial advice and best interests duty, so many institutions believe it's not possible.

Truth: Digital advice has evolved to satisfy BID.

Unlike its robo predecessor, digital advice is not limited to investments. It still uses fact-find and algorithm calculations for its advice. But, critically, it is well-governed, and has in-built compliance and safeguards to quickly and easily identify when customers are not suited to automated advice – either because of affordability, suitability or complexity.

Algorithms have now evolved to provide consistent, strategic and compliant advice. Where a robo-advice journey may have ten calculations in its algorithm, a digital advice algorithm has hundreds. Where robo-advice simply told you where to allocate your investment, digital advice tells you whether or not you should even be investing.

Olivia wants to save $800 per month for her wedding. She starts a digital advice journey with her wealth provider. When answering questions about her incomings and outgoings, the algorithm identifies that Olivia has some credit card debt and no emergency savings. She is provided strategic advice encouraging her to pay off debt and build an emergency fund first before starting to invest for her wedding.

The Best Interests Duty (BID)[20] states that advice provided by a digital advice service must enable both parties (the issuer of the advice and the technology solution provider) to demonstrate compliance with the BID related obligations. This can be done through controls built into the advice journey.

For example, 'collection of information' can be met through relevant questions, including current financial situation and the scope of advice being sought. Regular friction points prompt the customer to input, review and confirm information regarding their financial situation and intent in seeking financial advice. And the nature and type of the advice on offer are clearly labelled.

Other obligations such as 'identifying and responding to inadequate information' are met through field checks, friction points and prompts. The customer actively confirms that the information they're submitting is correct and complete at multiple stages throughout the advice journey.

Most importantly, digital advice algorithms can process and compare multiple advice scenarios based on customer inputs and legislative or institution-driven assumptions, and determine the advice that most closely links to the customer's goals.

Baking BID into the algorithm means customers are triaged out early on in the process if their need cannot be met within the scope of advice or the institution's product set. This means the advice provided at the end will be appropriate, strategic and thorough.

[20] RG 175 Licensing: *Financial product advisers—Conduct and disclosure*

Conclusion

The burden of financial advice compliance is significant for Australian institutions. It has contributed to declining adviser numbers and rising costs to serve. This means financial advice is more expensive and less accessible. Yet, the consensus is that advice needs to be less expensive and more accessible.

If advice at scale is the only way institutions can lower the cost, increase accessibility and remain profitable, how can they do it compliantly? We believe we have evidenced in this paper that digital advice is one of the answers and that it is well and truly possible right now within the letter of the law.

We've dispelled the common myths and shown how ASIC encourages single-issue advice, whether it is digital or human. We've laid out the guidance from the regulator on how institutions can confidently and safely provide advice on their own products, especially through a digital solution. And critically, how a digital advice solution can adequately and consistently satisfy BID through in-built compliance and design.

Institutions that recognise the intrinsic value that digital advice solutions can bring will be the ones to reap the rewards first and get ahead of their competitors. It will reduce operational and regulatory risk and lower the time and cost of compliance.

There are additional benefits too. As a customer engagement tool, it solves multiple problems. It is well documented that customers not only expect more digitally, but they also want more. Oracle's Money & Machines global survey[21] found that two in three people would trust robots more than humans to manage their finances. The turmoil of COVID-19 has left many doubting their financial management abilities. Meeting your customer where, how and when they want is no longer just a nice-to-have. It is essential for institutions looking to grow the volume of engaged and satisfied customers, which is ultimately reflected in the bottom line.

It also improves adviser economics. By using technology to do the heavy lifting, advisers can make their advice process more efficient. This makes for a better experience and allows them to free up time to service additional customers. Finally, and most importantly, digital advice helps more people access affordable, flexible and high-quality advice when they need it most—closing the advice gap and increasing societal financial wellbeing.

Contact Ignition today to discuss your enterprise goals.

[21] https://explore.oracle.com/money-and-machines/oracle-money-and-machines-report/

Digital advice. Made human.

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