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AUS Insights

Quality of Advice Review Proposals Paper and its implications for Digital Advice

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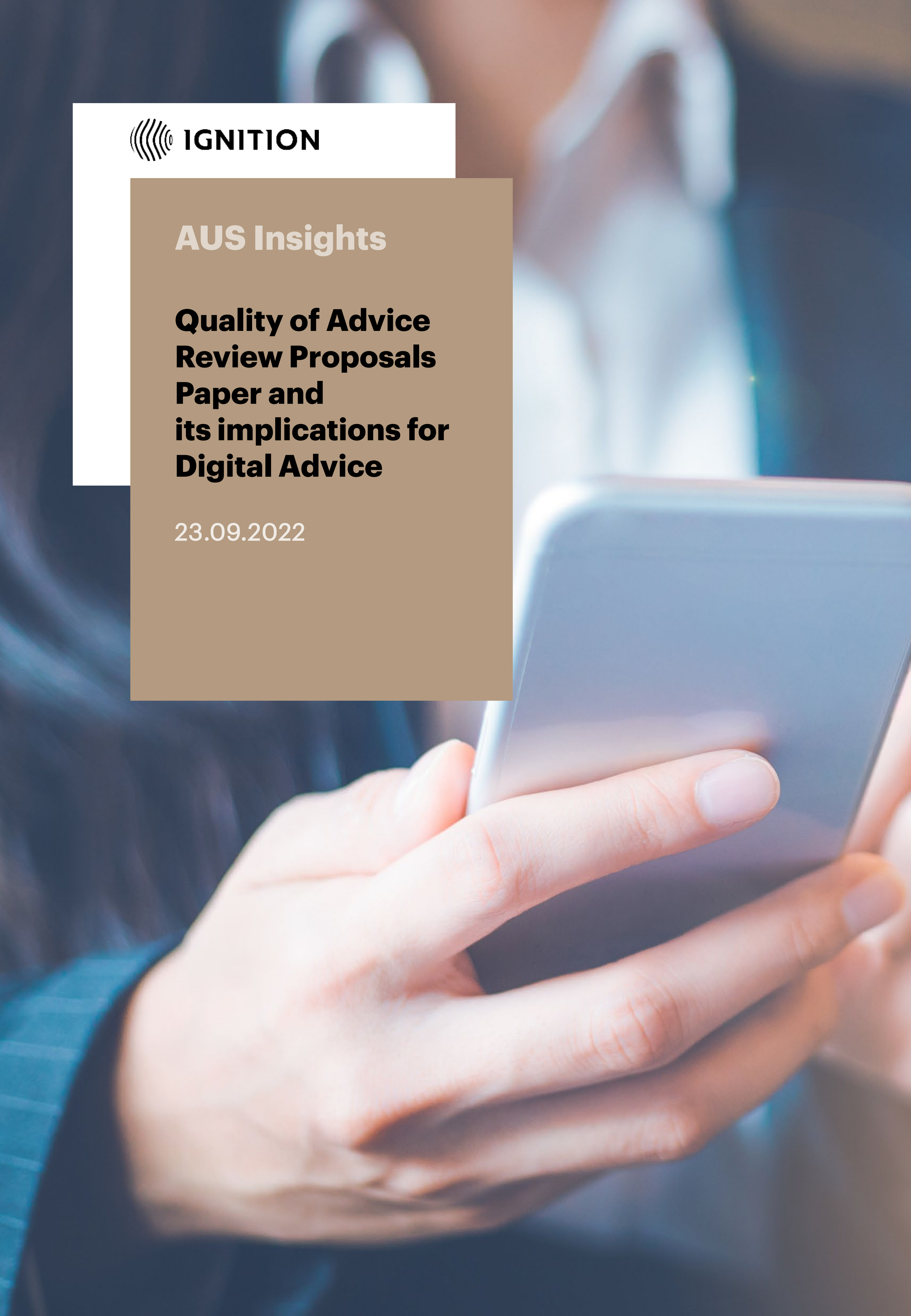

Perfect is the Enemy of Good (Advice)

The August 2022 Quality of Advice Review Proposals Paper outlines the thinking of the Reviewer and the likely direction of the final recommendations. These will be documented in the final report due to be provided to the Australian Government on 16 December 2022. The government will subsequently respond, including whether to support any or all of the recommendations.

Ignition Advice has been an active contributor to the Review given that digital advice was in scope. This paper provides a strategic overview of the proposals, our insights, and of course a focus on the implications for digital advice.

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Executive summary

After more than a decade of underwhelming reviews of the Australian superannuation and wealth management industry, the Quality of Advice Review (QAR) stands out by producing a Proposals Paper which has garnered broad support from across the industry. This includes both for-profit and not-for-profit constituencies, an achievement in itself.

The proposals have exceeded the expectations of many stakeholders in terms of a frank assessment of the current state of financial advice regulation, and by offering realistic solutions towards achieving the objectives of the Review: how the regulatory framework could better enable the provision of high quality, accessible and affordable financial advice for retail clients.

If a theme runs through the proposals, it is that "perfect is the enemy of good". Australia has a large but resolvable advice problem. Since the Royal Commission, advice quality has indeed improved but at great cost: the advice industry has shrunk and retreated upmarket. Advice has become more complex, less accessible, and significantly more expensive, placing it out of reach for many who might benefit from it. Advice has essentially been withdrawn from middle Australia.

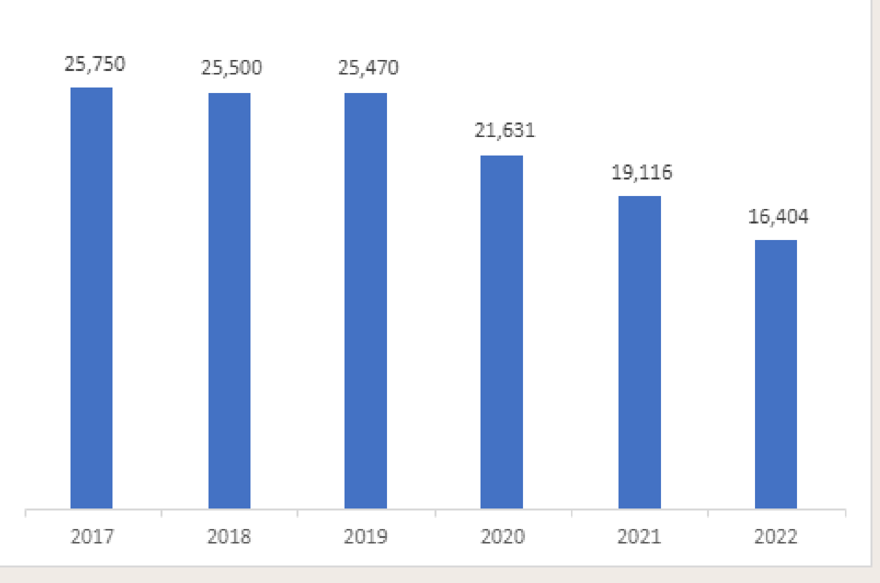
The current state may offer strong protections to consumers, but those protections are useless to those to whom advice is no longer accessible. Meanwhile demand continues to expand inexorably as older segments at peak advice demand grow rapidly.

Ms Levy offers a new model: good advice. She is explicit that this is not necessarily the "best" advice in any particular situation, nor advice which is exhaustive in its inquiries. It is advice which is reasonably likely to benefit the client based on their circumstances at the time the advice is given.

While no set of proposals is perfect, the good advice model offers a realistic path to high quality financial advice being available to all Australians who would benefit from it, in ways that are accessible and affordable. By realistic we mean that they can have a large rather than incremental impact on the problem.

Adviser numbers 2017-22

Source: Adviser Ratings



The Proposals Paper achieves this by pulling all the supply levers which can make a difference at scale:

- **Simplify regulation**
  Broaden the scope of personal advice, focus on outcomes, eliminate general advice…*creates a single advice "product" which will be delivered in larger volumes.*
- **Simplify advice**
  A "good advice" standard, which caters to and reflects the relative simplicity or complexity of the situation and provides more effective consumer protection while not pretending to be "best" or exhaustive….*simpler advice which benefits the client and can therefore be delivered at lower cost, faster, and at scale.*
- **Deepen supply via financial institutions**
  Broaden how advice is provided via more institutional involvement, and a wider spread of people within institutions delivering simpler advice…*consumers expect advice from their institution, and institutions should be providing it.*
- **Deepen supply via removing advice obstacles for super funds**
  As a category of financial institutions, super funds are an obvious source of advice for members; the Retirement Income Covenant also assumes this. The sole purpose test would be amended to expressly permit the provision of personal advice about members' interests in a fund, and to apply funds for that purpose, removing any doubts about the ability of super funds to provide personal advice, including about retirement issues….*in combination with the broadening of personal advice, super funds should become major providers of advice, especially simpler advice.*
- **Leverage supply via technology**
  Digital advice is key to making personal advice more accessible and affordable; digitally-delivered personal advice can be good advice just as much as human-delivered advice can be….*digital advice is the multiplier which allows a deeper supply of simplified advice to have a large-scale impact on access and affordability.*

In Ms Levy's world there will be more personal advice, more institutions providing it, and more consumers reaping the benefits of it. However, it is digital advice technology which glues it together. Digital advice allows good advice to be delivered at scale. Digital advice allows people delivering advice to be leveraged. Digital advice allows financial institutions to return to advice, and super funds to expand their advice delivery, in the knowledge that technology will provide assurance their advice is good advice, whether delivered by their people, technology, or both.

Ignition welcomes the Proposals Paper and is supportive of the good advice model. It is principles-based, simpler and more direct. Combined with proposals relating to relaxation of documentation requirements such as SoAs, encouragement of institutional participation, broadening the definition of who can provide personal advice, and delivery via digital advice, a good advice standard should substantially increase the supply of advice, particularly for simple advice topics.

Current state of advice regulation is not working

The Proposals Paper accepts that the current state of the advice landscape which advice regulation has shaped is counter-productive:

- Prevents many financial service providers, especially institutions, from offering advice (often due to post Royal Commission advice risk aversion, or qualitative perceptions of ASIC attitudes, rather than any explicit regulatory roadblocks).
- Inhibits development of digital advice (as Ignition Advice outlined in a September 2021 white paper, this confirms there is no implication that digital advice is not already compliant today).
- Makes comprehensive advice unaffordable for many.
- Advice supply is shrinking as adviser numbers decline.

This much is uncontroversial: the data points are extensive, and both the past and current responsible ministers acknowledge the problem. It could be added that the current state will likely get worse as demand for advice rises in parallel with an aging population.

The paper then considers the current state of advice regulation itself and concludes that regulation currently:

- Is complex and difficult to understand.
- Assumes all advice is provided by a (human) financial adviser.
- Is inflexible, i.e. all obligations apply to the individual providing the advice rather than the outcomes of the advice for the recipient.

A notable observation is that the current state of advice regulation is poorly suited to institutions that "*may want to or may be asked to give personal advice to customers*"; and therefore, financial institutions are reluctant to provide "*helpful personal advice*", a recurring reference in the Proposals Paper.

This is important because **achieving the Review's objectives requires a large advice supply response**. For example, simply easing the burden on traditional individual-based financial planning would have only an incremental impact on the accessibility and affordability of advice. Unless the Government proposes to offer advice (unlikely, but it must be noted that the UK Government has done so for pensions guidance via the Pensions Advisory Service), financial institutions are the most obvious source of a large-scale supply response.

The Paper's bottom-line current state conclusions are:

- It can be difficult for consumers to get helpful advice, especially simple one-off advice, at an affordable price.
- This might be justifiable if the current state was effective in protecting against harmful advice and / or there were not more efficient ways of protecting consumers from harm, but it is not at all clear that either is the case.

Proposed future state: "Good Advice" model of regulation

Having made the case for change, the Proposals Paper describes an advice regulation future featuring a fundamental change in its philosophy, switching the focus from process to outputs. This reflects a view that the quality of the advice (output) can be more easily measured than conduct (process).

The benighted general advice concept is destined for the regulatory scrapheap in favour of a much simpler advice regime of personal advice and product information.

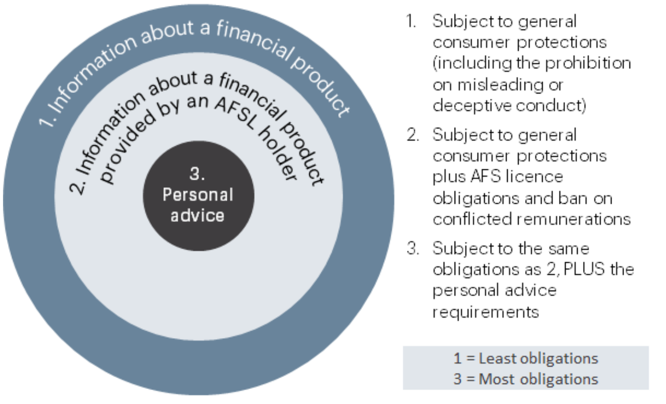
If elements of the new model seem somewhat familiar, that should not be a surprise – there are **significant parallels with the UK restricted advice model** where advice is limited to a set of products from a single provider. There is a long history of regulatory concept interchange between Australia and the UK, dating back to at least the Retail Distribution Review (UK) / Future of Financial Advice (Australia) reforms.

Many consumers do not understand the meaning of general advice, and further, do not understand or ignore general advice warnings. General advice would no longer be regulated but still subject to consumer protections including misleading / deceptive conduct.

Personal advice provision would be regulated, and its scope significantly broadened, so it applies when:

- **A recommendation or opinion is made about a financial product**, and
- **The provider has information about client objectives, needs, or any aspect of their financial situation** (this lowers the bar as the previous test was consideration, not just information about).

Proposed model framework



Source: Quality of Advice Review Proposals Paper

The cornerstone concept of personal advice is an obligation to provide good advice which is reasonably likely to benefit the client; what makes good advice depends on and can be assessed against the circumstances.

The Paper outlines that good advice:

- **Does not mean the "best" advice.**
- Does not necessarily require measures such as **comparison with alternative products** (unless presumably there is a recommendation to switch products).
- **Envisages collecting only that information about the client which is necessary for the advice sought** (rather than a time-consuming and error-prone comprehensive information collection exercise).

These criteria are essential for meeting the Review objectives. The search for perfection in advice, product comparison requirements, and extensive information collection all make the cost of advice unaffordable.

Good advice is a high-level definition, and while the Paper accepts there will be some ambiguity, it asserts that it will not be hard for a provider acting in good faith to determine what is good advice.

That said, we expect ASIC to issue regulatory guidance that expands on and clarifies it.

The obligation to provide good advice is channel-neutral – it applies irrespective of whether delivered by human or technology, and whether by an institutional employee or independent financial planner.

The good advice obligation would replace the current set of duties, such as best interests duty, appropriate advice duty, duty to warn the client, and duty of priority. Each of these four duties have highly prescribed processes to be followed in order to discharge them, the most infamous being the seven "safe harbour" steps for discharging the best interests duty. Whether these have actually been effective is open to debate. It has been argued (for example *"Tick-a-box 'best interest' test for financial advisers must go"*, AFR 14/9/22) that these steps have *"almost nothing to do with serving or advancing the client's best interests"*.

Despite some stakeholder claims to the contrary after the release of the Proposals Paper, this does not mean a dilution in consumer protection. Where personal advice is provided by an individual and the client is paying, the individual will be a "relevant provider", and remains subject to professional standards including education and Code of Ethics, which includes a best interests duty.

Ensuring advice is good advice will be the responsibility of the advice provider. The greater the risk of harm inherent in an issue, the more work a provider must do to be satisfied. For example, life insurance may be seen to involve more risk of harm than investment or superannuation contributions. This means assurance at scale will be essential.

Another unloved aspect of the current state proposed to be scrapped is the need to document personal advice in a highly prescribed manner, namely in a Statement of Advice (SoA) or Record of Advice (RoA). Taking a substance over form approach, the Paper argues that the current highly prescribed form is unhelpful and suffocates innovation and does not deliver what the customers want and need. The proposed approach is to allow providers to determine the form of advice delivery (and to encourage innovation in doing so), and to focus on what is actually delivered to the customer (i.e. good advice).

Digital advice an essential part of the future state

In arguing that current advice regulation has had counter-productive effects, the Paper also considers it is poorly suited to digital advice due to the assumption that an individual provides the advice.

Accepting that digital advice can be provided in a compliant manner today, the regulatory environment should be more holistic, taking into account that advice can be delivered by individuals, technology, or hybrid combinations of both.

The Proposals Paper is highly supportive of digital advice generally, and accepts the views put forward by Ignition Advice (and others) about the role and benefits of digital advice. There is an acceptance that technology must play a critical role in increasing the supply of good advice, and that digital advice can be good advice just as much as human delivery advice can be.

Digital advice is not lower quality advice; the Paper asserts specifically that the provision of digitally-delivered good advice would not expose customers to the risk of poorer quality advice and would make personal advice more accessible and affordable.

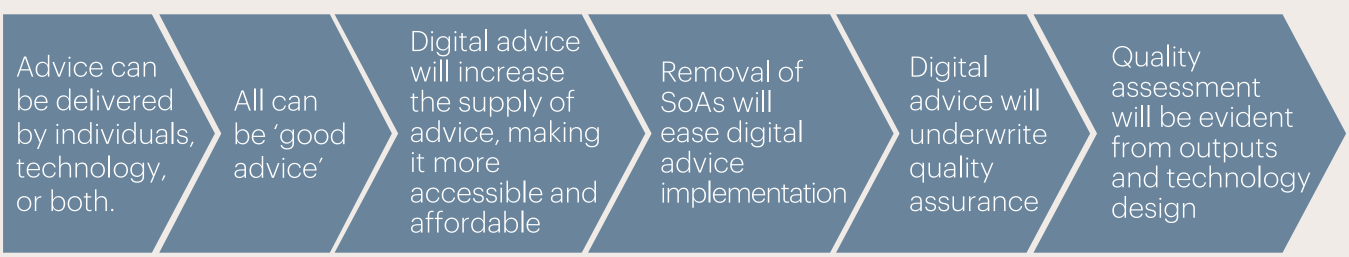
The changes to disclosure via SoAs are also highly favourable for digital advice (not just traditional financial planners) in reducing the complexity of institutional configuration and implementation. The flipside of the proposed removal of SoAs is that regardless of the form of communication adopted by the advice provider, all records must be retained – a model which favours permanent record retention offered by a digital advice engine.

The obligation to give good advice should make it easier for digital advice providers (which may be financial institutions) to give personal advice, and assessing that it reflects good advice, will be able to be performed from the outputs and the design of the program.

The only material shortcoming of the Paper in respect of digital advice is that it assumes the provision of digital advice would be a direct-to-consumer tech-only channel. It overlooks the hybrid human / technology models which have dominated the early evolution of digital advice in UK / Europe, where human advisers are still active in the advice process either via issues triage and / or advice confirmation.

In industry feedback forums since the release of the Proposals Paper, we have raised with the Reviewer and secretariat, that consistent with UK / Europe, the majority of digital advice volume is much more likely to be hybrid models offered by financial institutions. Without doubt there will be propositions which are principally D2C channels to digital advice, but these are likely to be niche by comparison to the offers of financial institutions. We expect to see this feedback reflected in the final report.

Role of digital advice in the Good Advice framework



Source: Ignition Advice analysis

Bigger role for institutions in advice

The return of financial institutions as large providers of financial advice, especially simpler advice, is a key pillar of the Proposals Paper. This has several aspects:

- Regulation: Institutions will be drawn back in by the broadening of personal advice and the scrapping of general advice.
- Customers: Customers expect and want to be able to get personal advice from their financial institution, and financial institutions should be encouraged to respond accordingly.
- Economics: Advice has increasingly become a cottage industry since the Royal Commission. Only financial institutions have the resource scale to impact advice supply so that there can be a significant improvement to access and affordability: their return is essential.

The proposed definition of personal advice suggests many interactions by financial institutions with existing customers will become personal advice, and therefore financial institutions will see a large increase in personal advice interactions.

Personal advice avoidance strategies, such as the quarantining of customer information, would not be available. The Paper notes that many financial institutions do not want to provide personal advice under current regulation and obligations, and therefore try to "shoehorn" what should be personal advice conversations into general advice. It is clear the Reviewer does not approve of this.

It is observed that customers expect to be able to get personal advice from their financial institution, which already holds information about them. Consumers want and benefit from "*specific, direct, straightforward advice which considers their personal circumstances*". When consumers contact their financial institution, they expect the institution to have taken into account what it already knows about the customer.

Financial institutions should therefore be encouraged to engage with customers' "*objectives, financial situation, and needs*", and to use the information they have to provide helpful advice. The good advice concept should make it easier for financial institutions to give simple personal advice because:

- There will be no prescribed process, and
- Advice can be provided a staff member who is not a relevant provider; i.e. an employee who is not a specialist financial adviser (the Proposal Paper case studies include a call centre employee providing simple advice as an example).

Given the shrinking number of human financial advisers, institutional advice models will be essential to increasing access and bringing down advice costs, but clearly this comes with a need for strong assurance controls.

The institution (or licensee) will continue to have an obligation to ensure those staff delivering advice are competent, adequately trained, and supervised. In practice this will almost certainly be achieved via digital advice technology.

For example, using the case study of a financial institution call centre employee dealing with a simple advice issue:

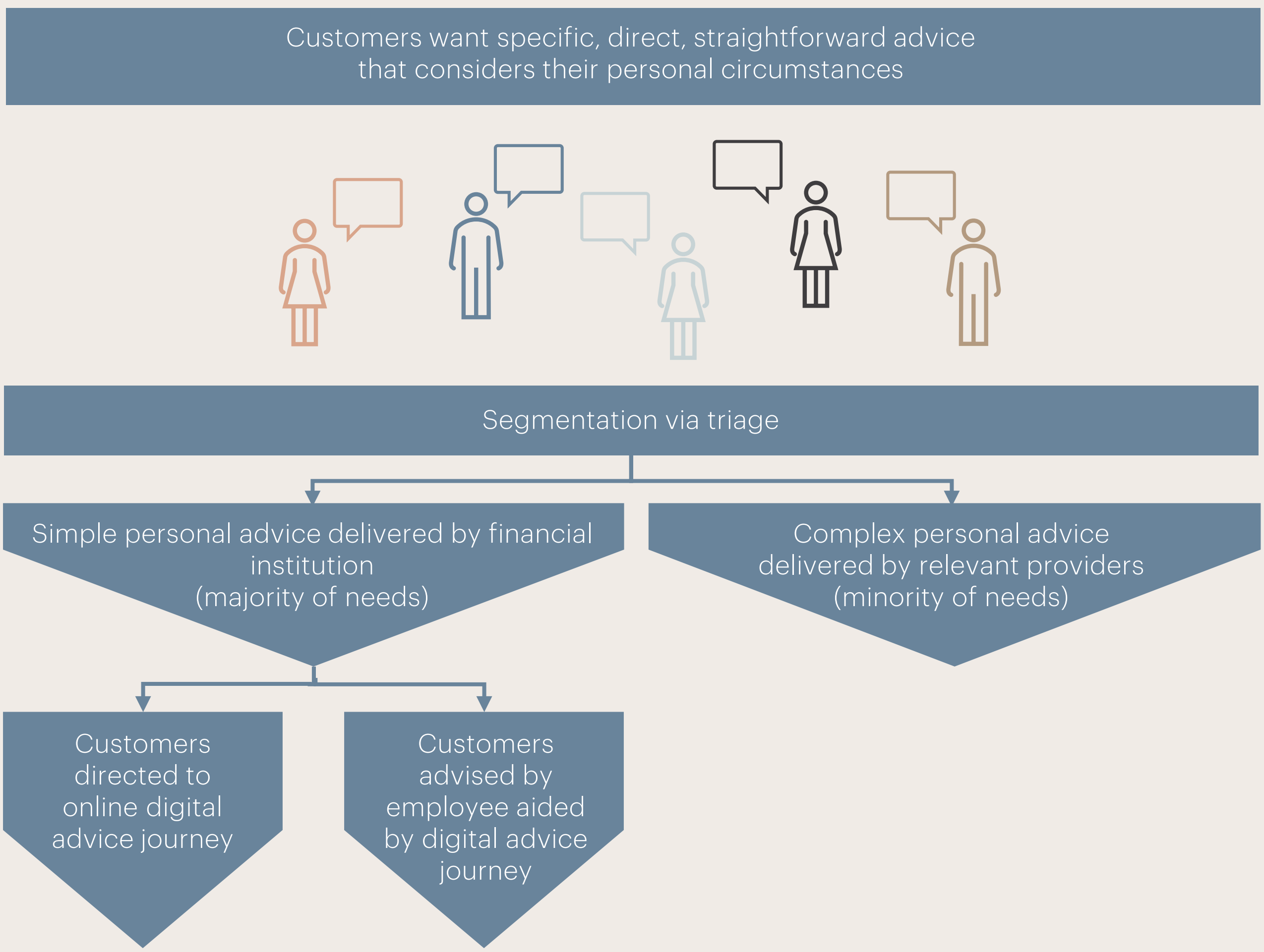
- The employee taking the call directs the customer to a digital advice journey online at the financial institution's website.
- Alternatively, the employee deals with the issue personally in combination with the digital advice journey on their screen.

For institutions, the Paper maps out a logical segmentation model of future personal advice provision:

- Simple personal advice delivered by financial institutions via staff who are not professional financial planners and / or digital advice.
- More complex personal advice referred to and delivered by relevant providers.

We illustrate below a potential framework by which institutions can bring this to life:

Hypothetical framework of institutional Good Advice



Source: Ignition Advice

Objections have been raised to the prospective re-entry of financial institutions to advice. This largely consist of arguments that the advice conduct behaviours and consumer harms which led to the Royal Commission will surely recur. However, this is rear-vision mirror thinking in a world which has changed considerably in the years since.

The Paper asserts that the advice industry has learnt and matured. Ignition also highlights the effect of the contemporary institutional ESG environment, which has created a powerful set of carrot and stick incentives for financial institutions, their CEOs, and boards. One of the top drivers of (career-limiting) ESG controversies for financial institutions is advice conduct risk. A sense of self-preservation, and the ability of digital advice to provide a high level of assurance in relation to conduct risk, means that the return of financial institutions to advice will look very different.

Super funds should be giving more advice

As a category of financial institutions, it is no surprise super funds are also encouraged by the Proposals Paper to become more active in personal advice provision to their members.

The Paper states that super funds can be an important source of financial information and helpful personal advice, and that they should be encouraged to do so. The distinctions between super funds and other types of financial institutions are identified and discussed, particularly:

- Duties to fund members.
- Sole purpose test, and the lack of clarity within the sole purpose test as to whether trustees are permitted to apply assets to the cost of delivering personal advice.

Given the desirability of super funds offering personal advice. and the lack of clarity in the sole purpose test within the SIS Act, it is proposed that the sole purpose test be amended to expressly permit the provision of personal advice about members' interests in a fund, including in relation to retirement, and to apply funds for that purpose. Should this occur, section 99F of the SIS Act, currently accepted as permitting intra-fund advice, would become redundant and is proposed for repeal.

As with financial institutions generally, regulation will act as something of a tractor beam drawing super funds further into personal advice:

- There is a specific reference in the Proposals Paper that the **Retirement Income Covenant assumes that trustees can provide related advice to their members.** An inference is that this already effectively extends intra-fund advice to retirement income issues if a trustee's powers and duties permit it.
- The Proposals would **extend the scope of intra-fund advice to retirement issues** (keeping in mind that what we currently understand as intra-fund advice becomes personal advice under the sole purpose test, which can be collectively charged); and broaden it to issues including the member's assets / other personal circumstances, social security, and their partner's financial position where applicable.
- As discussed earlier, **many interactions with members now considered general advice will become personal advice.**

- Specifically in relation to super funds, we understand the current view is **that fund consolidation performed by super funds via ATO super searches would also typically now be considered as personal advice.** The fund obviously has information about the member (one of the key criteria). If this view succeeds it would have a big impact, as many super funds actively facilitate consolidation activity. Funds want to encourage inbound consolidation, and it is usually in the interests of members to remove duplication of fees and insurance premiums.

  In theory, a fund could make consolidation online-only and form a view that no recommendation / opinion was being offered, therefore keeping consolidation outside of personal advice. However, this strategy has big holes, including that a proportion of members will prefer to speak to a fund employee either entirely or for confirmation (the Paper's "*helpful personal advice*" construct), and / or will have insurance cover which needs advice in the process of consolidation (definitely personal advice).

Overall, the Proposals would make super funds much more relevant as a source of advice; but they also represent a significant step-up in capability required by funds to handle the increased volume of personal advice contemplated.

Given the broadening of personal advice proposed, an implication is that super funds may spend considerably more on advice than at present. That said, advice usually is a very small part (<5%) of a super fund's cost structure, dwarfed by investment expenses and many other expense categories.

The proposition that a super fund should spend considerably more on personal advice than today should not be controversial. A super fund spends 50-100bps every year, for decades, building up their members' balances – which can be quickly dissipated due to a lack of advice, or poor advice. Spending more on the provision of good advice to ensure as many members as possible actually realise their benefit in retirement, is a logical decision to protect that decades-long investment.

Notwithstanding that advice costs will still be a minor portion of costs even if expanded, trustees providing personal advice will need to consider how to allocate the costs of doing so to members.

There is an implication in the Paper that simple personal advice (for example current intra-fund advice topics and simpler retirement advice) might be collectively charged to the fund (therefore likely increasing advice spend), while more complex advice would be specifically charged to members, whether to their fund balance or otherwise.

No change to the prohibition of ongoing advice fees from MySuper is proposed, but the Paper accepts that advice, including "possibly" regular advice, can increase retirement income, and therefore members should be able to use their super for the cost of receiving advice about their super, including retirement income. However, the Paper does not support using super to fund broader financial advice.

About the author

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With over 30 years' experience in the financial services industry in a range of senior roles in Australia and Europe, Andrew is well known as the founder of industry consulting firm Tria Partners.

More recent roles include within industry at AustralianSuper and QSuper, and Global Partner and UK & EMEA lead of NMG Consulting's London practice. Andrew is a Sloan Fellow and holds an M.Sc. in management (distinction) from the London Business School and a Bachelor of Business (economics/management) from Monash University.

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