9 March 2020

Mr Michael Callaghan AM PSM
Ms Deborah Ralston
Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: retirementincomereview@treasury.gov.au

Dear Mr Callaghan and Ms Ralston

Review of Retirement Income System

The Financial Planning Association of Australia[1] (FPA) greatly appreciates Panel Members taking the time to meet with FPA's CEO, Dante De Gori, and myself to discuss the retirement income system and the role of financial advice in helping consumers to understand the three pillars and improving in the cohesion of the system.

We welcome the opportunity to provide the Panel with a supplementary submission based on the matters raised during our discussion, for consideration in its Review of the Retirement Income System.

We would welcome the opportunity to discuss with the Review any matters raised in our supplementary submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

Ben Marshan CFP® LRS®
Head of Policy and Professional Standards
Financial Planning Association of Australia

[1] The Financial Planning Association (FPA) has more than 12,919 members and affiliates of whom 10,618 are practising financial planners and 5,540 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:
- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent Conduct Review Commission, chaired by Dale Boucher, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 26 member countries and the more than 175,570 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 18 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally.
- We are recognised as a professional body by the Tax Practitioners Board.

Review of the Retirement Income System

FPA SUPPLEMENTARY SUBMISSION

9 March 2020

Submitted to:

The Review Panel

Financial Planning Association of Australia
GPO Box 4285 Sydney NSW 2001
fpa@fpa.com.au
www.fpa.com.au
t 1300 337 301
ABN 62 054 174 453

Value in receiving advice

The following research reports present findings on consumer's views about financial advice, quantify the financial and non-financial consumer benefits of financial advice, and identify some of the barriers to financial advice from the consumers' perspective. The FPA recommends the Review consider the following reports in their entirety.

ASIC's consumer research

ASIC Report 627 - *Financial advice: What consumers really think* (August 2019)[2] provides valuable information regarding the consumers' view of financial advice.

The Report includes consumers' views on the cost of financial advice:

> *"In the online survey, perceiving financial advice as too expensive was the most commonly identified reason for not seeking advice (35% of participants, excluding Group A). Overall, 64% of all the online survey participants agreed that financial advisers were too expensive.*
>
> *"Only 29% of the online survey participants agreed that financial advisers provided good value for money, while 26% disagreed and the remainder could not say either way.*
>
> *"Moreover, some participants were not convinced that financial advisers could provide value beyond what the participant could achieve by managing their own finances and/or by seeking guidance and information from free sources (such as family, friends and colleagues). In the online survey, 37% of participants agreed that they could do just as well as a financial adviser when it came to managing their own financial future."*[3]

It also considers why consumers get financial advice and the barriers to consumers getting advice.

CoreData analysis for MLC Wealth

In its submission to the Retirement Income Review, MLC Wealth cited CoreData research which assessed a number of typical scenarios to investigate the degree to which advice could have an impact on Australians with complex needs leading up to retirement.

> *"This indicated that across the scenarios, advice had a positive impact on net financial assets. While the amount of the increase depended on the client circumstances, the advice provided, and the length of time between the provision of advice, retirement and life expectancy; in the common client scenarios advice increased net financial assets by over 20%; while in the more complex client scenarios, involving the sale of a business, advice delivered an uplift of over 35%."*[4]

[2] https://download.asic.gov.au/media/5243978/rep627-published-26-august-2019.pdf
[3] ASIC Rep627 para 80 – 83, August 2019
[4] MLC Wealth submission to the Retirement Income Review, February 2020, pg 24, https://treasury.gov.au/sites/default/files/2020-02/mlc040220.pdf

Vanguard – Assessing the value of advice

Vanguard's research: *Assessing the value of advice* introduces a new three-part framework based on portfolio, financial, and emotional outcomes to measure the value of advice.

The results showed that:

- Value comes from building a well-diversified portfolio that generates better after-tax risk-adjusted returns net of all fees, suitably matched to the client's risk tolerance. The impact that advice can have on previously self-directed investors' portfolio outcomes, included adjusting portfolio risk-levels, fully investing in fixed income securities rather than in cash reserves, and eliminating home bias. The advice also led to a higher passive fund share and substantially reduced or eliminated single-stock risk.
- As of January 2019, eight in ten PAS investors with a retirement goal had an 80% or greater probability of achieving their objective; specifically, 76% had a 90% to 100% probability, while another 4% had a probability of between 80% and 89%. The remaining one-fifth had much lower probabilities.
- data allowed Vanguard to model how clients perceived value in the advisory relationship and then to estimate how much of that value was related to emotional perceptions.

Fidelity International – The Value of Advice Report

Fidelity International's The Value of Advice Report[5] is based on an extensive survey of 2,228 Australians. The Report considers the implications of financial wellbeing on an Australians' overall wellbeing, such as the stress and anxiety of money matters. For example, Fidelity's survey found that

- 65.7% of Australians say they worry about money at least monthly,
- 37.4% of Australians say financial issues have affected their physical health,
- 52.8% of Australians say financial issues have affected their mental health, and
- 48.0% of Australians say financial issues have affected how they get along with family and friends.

The survey also found that Australians who have never directly experienced the benefits of financial advice are often unaware of its importance in addressing overall wellbeing, and the motivations for seeking advice vary greatly and depend on the circumstances of the individual – approaching retirement ranked as the highest motivating trigger for seeking advice.

The Report highlights the value of advice:

- almost three quarters (74.3%) of Australians currently receiving financial advice say their financial wellbeing has improved as a result

[5] https://www.fidelity.com.au/insights/investment-articles/the-value-of-advice/

- 88.5% of Australians receiving advice believe it has given them greater peace of mind financially
- 86.2% of Australians receiving advice believe it has given them greater control over their financial situation
- More than seven in 10 (71.3%) Australians currently receiving advice believe it has generated more value to them than it has cost.

"A key insight from Fidelity International's Financial Advice Survey is that more than three-quarters (77.1%) of Australians receiving advice were able to achieve their personal goals using financial advice. The ability to live to their expectations was key, as well as fewer stressors and achieving improved mental wellbeing."

The survey found a recurring theme among Australians who have never sought advice before is that they cannot see the value in it. More than a third of Australians who have never sought advice say they believe it is too expensive – that they cannot afford it; and more than a third believe that their circumstances do not justify it.

The Report highlights common barriers to seeking advice for Australians who have never received advice:

- 66.0% want more information about the fees and costs of advice.
- 44.6% want to know more about the products and services that advisers can offer.
- 43.9% want to know how their money might be invested.
- 41.4% want to know more about the benefits of financial advice - Will they at least get back what they pay in terms of value?
- 40.7% want to know more about their adviser's track record with clients similar to themselves

Cost of providing financial advice

As this is an ongoing issue, the FPA has raised concerns about the raising costs associated with providing advice with Government and other stakeholders, including in our recent submission to Treasury's pre-Budget consultation process in February 2020. As evidence shows that personal financial advice can make a significant contribution to the cohesion of the retirement income system, the FPA has included in this supplementary submission the recommendations made to Treasury to improve the cost of personal advice for consumers.

Financial planning in Australia is going through an unprecedented period of change. Financial planners are responding to a wide range of factors, including:

- changing market structures, with major licensees exiting or reducing their presence in the financial advice sector;
- significant new reforms that are changing the way financial advice is provided;

- rapid increases to regulatory costs;
- changes to how financial planners are paid for their work;
- clients with evolving expectations of how their financial planner interacts with them; and
- reduced public trust from misconduct identified by the Financial Services Royal Commission.

The totality of these changes are affecting the long-term viability of the financial planning profession.

Addressing misconduct and creating industry-wide ethical and educational standards is a necessary part of professionalisation and we support the regulators' work to achieve this. The Financial Services Royal Commission revealed practices which are inconsistent with a modern profession and must change to restore trust in Australia's financial services sector.

However, new standards are applying on top of an already complex regulatory framework that has evolved over several decades. While the FPA supports the introduction of many of these reforms, the rapid increases to the cost to practitioners of additional regulation are a serious risk for small and medium-sized financial planning businesses.

Major financial institutions, including Australia's big banks, are leaving the financial advice business or reducing their presence. Many practitioners are sole traders or work in small and medium-sized practices and their ability to absorb additional regulatory costs is extremely limited. Escalating regulatory costs will result in financial advice becoming more unaffordable and unavailable for many Australians.

Unrestrained cost increases will force the closure of financial planning businesses, reduce employment in the sector and set back the development of the financial planning profession.

The Government must investigate the recent increases to regulatory costs and carefully consider its reform agenda to ensure that, while it achieves its goals of protecting consumers and restoring trust in the financial services sector, it does not also damage the financial planning profession and make it more difficult for Australians to access qualified and independent financial advice.

The costs to practice as a financial planner come in two forms.

Firstly, financial planners face the cost of mandatory fees, charges, industry levies and insurance premiums.

The number and quantum of these costs has been rapidly increasing and is projected to continue increasing in the near future. The variety of business models and structures in the financial planning sector makes it difficult to establish a single figure for all financial planners.

All planners are subject to the following costs. The major government charge is the ASIC cost- recovery levy. In 2018-10 alone, the ASIC levy increased 26 per cent over ASIC's estimate for that year. Licensees were expecting a levy of $907 per financial planner and this has now escalated to $1,142, with an additional minimum charge of $1,500.

Financial planners must be registered on the Financial Adviser Register, with all costs of running the register recovered from industry on a fee for service basis. Financial planners must also be authorised representatives of an Australian Financial Services Licensee (AFSL), with licensee costs recovered from each planner.

Most financial planners are also required to register with the Tax Practitioners Board (TPB). The TPB does not currently operate on a full cost-recovery basis but, if the Government decides to proceed with this approach, the expectation is that the TPB registration fee will need to increase substantially from the current $550 over three years.

Through their Australian Financial Services License, financial planners must also be a member of the Australian Financial Complaints Authority (AFCA), with an associated annual charge.

As a condition of their license, financial planners must have professional indemnity insurance. Insurance premiums have been escalating rapidly, regardless of whether a practitioner has been subject to a complaint or a finding from an external dispute resolution process. Insurers are leaving the market. Some practitioners are finding it very difficult to renew their professional indemnity insurance and taking out new cover has become virtually impossible.

In the near future, financial planners are likely to be subject to additional government cost recovery for a new sinlge disciplinary system and a compensation scheme of last resort, to name two reforms from the Royal Commission implementation road map.

Secondly, financial planners have the cost to their business in productivity in complying with regulation.

Financial advice is primarily regulated through its connection to financial products. Financial advice is currently defined as advice about a financial product, despite this being only one minor part of a holistic piece of financial advice. Financial planners must have an AFSL or, more commonly, must be an authorised representative of a license-holder.

The cost of being an authorised representative for an AFSL has been rising rapidly, both in terms of the fees paid by a financial planner to hold an AFSL or be an authorised representative, and the burden on their business in complying with their AFSL's requirements. Planners must satisfy the compliance demands of their AFSL, which vary and often go beyond what is set in the law and ASIC guidance. ASIC Report 515 has led to many licensees creating long and expensive compliance reviews to their advice processes which can lead to significant delays of over three months to provide advice to their clients.

In addition to the AFSL framework, over the last three years the Government has focused on introducing individual registration and accountability. Planners have personal obligations to meet ethical and education standards and will be subject to registration and oversight from a single disciplinary body.

The interaction of existing AFSL-based regulation and new personal obligations has not been fully investigated. While personal obligations are a key part of professionalisation, they are in parts duplicating obligations that continue to exist through the AFSL framework. This duplication and the increasingly complex web of regulations covering financial planning is dramatically increasing the cost of compliance for financial planners.

Increases to the cost of practicing as a financial planner are occurring at the same time as significant disruption and reform to traditional revenue arrangements for planners.

Changes to remuneration arrangements for financial planners are many and varied. Commissions on investment products are being phased-out in 2020. Commissions on life insurance products are being phased down under the Life Insurance Framework reforms. Regardless of the merits of these policy changes, they are resulting in many financial planners needing to make substantial changes to their business models.

As part of the Government's response to the Financial Services Royal Commission, ongoing fee arrangements will be subject to new conditions and there will be restrictions on consumers using funds from their superannuation to pay for financial advice.

Financial planners are increasingly moving to fee-for-service arrangements, but this process can take time. The short-term disruption that these reforms can cause must be managed at the same time as increasing regulatory costs, insurance costs, and other major industry changes.

Increasing costs are flowing on to Australian consumers, putting financial advice out of reach of many.

The cost of delivering a statement of advice has recently been estimated at $6,500, which is several times the typical fee-for service in recent years of $2,400. With reduced options for paying for advice, including amortising the cost of advice over multiple years, consumers are increasingly finding that they will have to pay high upfront fees. This is putting financial advice out of the reach of many Australians.

At a time when the retirement income system is becoming increasingly complex, Australia also has an ageing population and relatively low levels of financial literacy (as discussed in the FPA's submission to the Retirement Income Review). Additional obstacles to Australians accessing personal financial advice will negatively impact their ability to prepare for retirement and enjoy a desired standard of living during retirement.

Recommendations

To address this issue, the Government should start by establishing the scale of the challenge facing Australians in affording personal financial advice, particularly due to escalating regulatory costs. Without this evidence base, decisions about future reforms will not be informed by a clear picture of the consumer and their interests.

The FPA recommends that the Government, through ASIC, monitors the increasing cost to practice as a financial planner, including through government fees and charges, cost-recovery levies and increases to professional indemnity insurance premiums, and the impact this is having on the affordability of financial advice.

FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

Tax deductions are already available for consumers who seek advice on the management of a specific asset or investment which generates ongoing taxable income. The same tax deduction is not available for an initial holistic financial plan, which is the first and most important step in seeking financial advice.

The lack of consistency in the approach to tax deductibility is an obstacle for low and middle- income Australians in seeking financial advice. All financial advice should be subject to the same ability to claim as a tax deduction. If the Government is concerned about the fiscal impact of this approach, it could institute a cap on the amount that can be claimed as a deduction, ensuring all Australians are able to benefit from the arrangement equally.

The FPA recommends the Government provides a tax deduction for fees associated with the preparation of an initial financial plan and for subsequent reviews of a financial plan.

The Government should consider regulatory burden and the impact this has on access to financial advice as a key factor in evaluating the future reforms of financial planning regulation.

When evaluating options for reforming the regulation of financial advice, the FPA recommends the Government selects options that reduce duplication of regulation, provide clear and effective oversight, and seek to minimise further increases to regulatory costs for practitioners.

Lack of competition in professional indemnity (PI) insurance is resulting in rapid increases to insurance premiums for financial planners. A well-functioning market for PI insurance is critical to ensure financial advice remains available for Australian consumers and that consumers remain protected. As PI insurance is a corner-stone of the regulation of financial advice, the Government has a role in ensuring that it remains available, affordable and gives appropriate coverage.

The FPA recommends the Government, through ASIC, monitors the operation of the professional indemnity (PI) insurance market in Australia and considers options to promote confidence in the regulation of financial planning and transparency in the setting of PI insurance premiums.