

Quality of Advice Review Issues Paper

Submission

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About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, The Institute is supported by the insights of a high-quality advisory board, whereby each member's involvement is on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Research is generally made open source to create transparency and accountability. The Conexus Institute exists with no commercial relationships. Further information [here](#).

About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio [here](#).

***** The author is willing and able to participate in further consultation. *****

1. Executive Summary

The Quality of Advice Review will be difficult for panel members due to the morass of law and regulation, and the operating models that have developed as a result.

The Conexus Institute comes to the Review as an independent party focused on provision of financial support services to all Australians. Our specific focus is support at the point of retirement, a case study we carried through this submission. The scale of the retirement challenge (250,000 retirees a year) is significant and no matter the changes to reduce compliance obligations for financial advisers, other mechanisms will be required to support most of those retirees.

Achieving a legal and regulatory setting which facilitates provision of support while protecting consumers is a significant challenge for this Review.

In this submission we explore a range of areas and attempt to provide useful insights. We remain most concerned about the lack of consideration given to vertical integration. This is fundamental to the design of mass solutions required to support Australians. Exploring the issue removes uncertainty and facilitates investment.

2. Further detail

2.1. Case Study: The Retirement Challenge

Throughout this submission we use retirement as our central case study.

Retirement through the consumer lens

Note that this section borrows heavily from the paper "[Retirement transition support that is safe by design](#)" by Pamela Hanrahan and David Bell (2021). We use the word "support" to capture the essence of what guidance and advice may provide.

More than 250,000 Australians with superannuation accounts are retiring every year; most are receiving no targeted and reliable guidance on the level and security of their retirement income. Three decades into the compulsory superannuation system, choice support at retirement remains an important missing piece of the jigsaw.

People who have accumulated savings in the superannuation system need support, as they approach retirement, in deciding how to manage the decumulation phase to optimise their household financial outcomes in retirement. For most people, this includes having a regular and reliably predictable income that lasts their whole life and having some accessible savings to meet unanticipated expenses. Housing security, future health and aged care needs and costs, family structure and commitments, the possibility of part-time work, tax, and social security are relevant considerations.

Pre-retirees need support because the system is complex. As the [Retirement Income Review](#) (RIR) observed, reducing complexity might reduce the need for support, but under current policy settings (which include no default option for decumulation) it cannot be eliminated. Expert support is important because the decisions about transition to retirement require technical knowledge and expertise that cannot realistically be met optimally by 'self-help' solutions, generic guidance, or improved financial literacy (although this is important too).

Meaningful support is best provided having regard to the pre-retiree's attributes and financial situation. Under existing legal and regulatory settings, this means support is usually classified as 'personal financial product advice', which carries with it complex regulatory requirements for providers. The prevailing view is that the regulatory requirements make (or substantially contribute to making) it too cumbersome or expensive, and too risky from a compliance perspective, to provide support in a form and at a price that is attractive to most pre-retirees. Whether this industry position is technically correct, the market is either unwilling or unable to provide widespread support under the existing settings.

For most working households, wages fund consumption and the Superannuation Guarantee underpins savings for retirement. Australian's longstanding affinity for home ownership represents an additional (tax-effective) savings mechanism which provides accommodation and a potential source of both accessible capital and retirement income.

Analysis presented in the RIR demonstrated that these arrangements, accompanied by the age pension, voluntary savings, and hypothetically efficient retirement solutions should, in theory,

deliver (for most households) a level of retirement ‘income’¹ considered to be adequate.² An important exception here is the case of single renters.

But pre-retirees face two challenges, and both are confronting.

The first challenge is the significant change to how household consumption is funded. During their working lives, employment has been the foundation of their livelihoods; now it is achieved through the management of financial assets, supported by the age pension. As a result, many households will experience a loss of control, uncertainty, and likely a degree of anxiety because, putting aside the age pension, those financial assets do not provide anything remotely like a retirement ‘pay cheque’.

The second challenge is the complexity of the retirement financial problem. Nobel laureate William Sharpe describes this as the *“nastiest, hardest problem in finance”*³. Complexity is underpinned by two sources of uncertainty: we don’t know how investments will perform nor how long we will live. Academics and other researchers have been exploring this problem for decades, using advanced stochastic modelling techniques beyond the grasp of non-specialists.

The complexity of the problem exacerbates the concerns households might have when they retire. Households are exposed to a range of behavioural biases in retirement and a common outcome is that they spend too conservatively. The RIR summarised this finding:

“Retirees are generally reluctant to draw down their savings in retirement due to complexity, little guidance, reluctance to consume funds that are called ‘nest eggs’, concerns about possible future health and aged care costs, and concerns about outliving savings.”

Retirement through the industry lens

We use the term “Retirement Challenge” to define industry’s task of supporting consumers into quality retirement solutions. This involves two broad elements, as framed in Figure 1. One is the product solution piece which involves an appropriate mix of products accompanied by a drawdown plan. The other component is the challenge of engaging with consumers to identify their personal situation and preferences, and then supporting them into appropriate solutions (including the challenge of disengaged consumers).

¹ Consumers, and to a degree, industry participants, have different interpretations of retirement ‘income’. We use the definition provided in the RIR: *“Income during retirement, including income streams and withdrawals from superannuation, the Age Pension, and drawdown of non-superannuation assets.”*

² When it comes to ‘adequacy’, we again stay close to the RIR: that *“The system should ensure a minimum standard of living for retirees with limited financial means that is consistent with prevailing community standards”* and *“The system should facilitate people to reasonably maintain their standard of living in retirement.”*

³ *“Tackling the ‘nastiest, hardest problem in finance’”* by Barry Ritholtz.

From a super fund perspective, where The Conexus Institute undertakes significant industry engagement, the anecdotal indications are that it is the engagement piece (the vertical part labelled “solution delivery”) which is more difficult and uncertain.

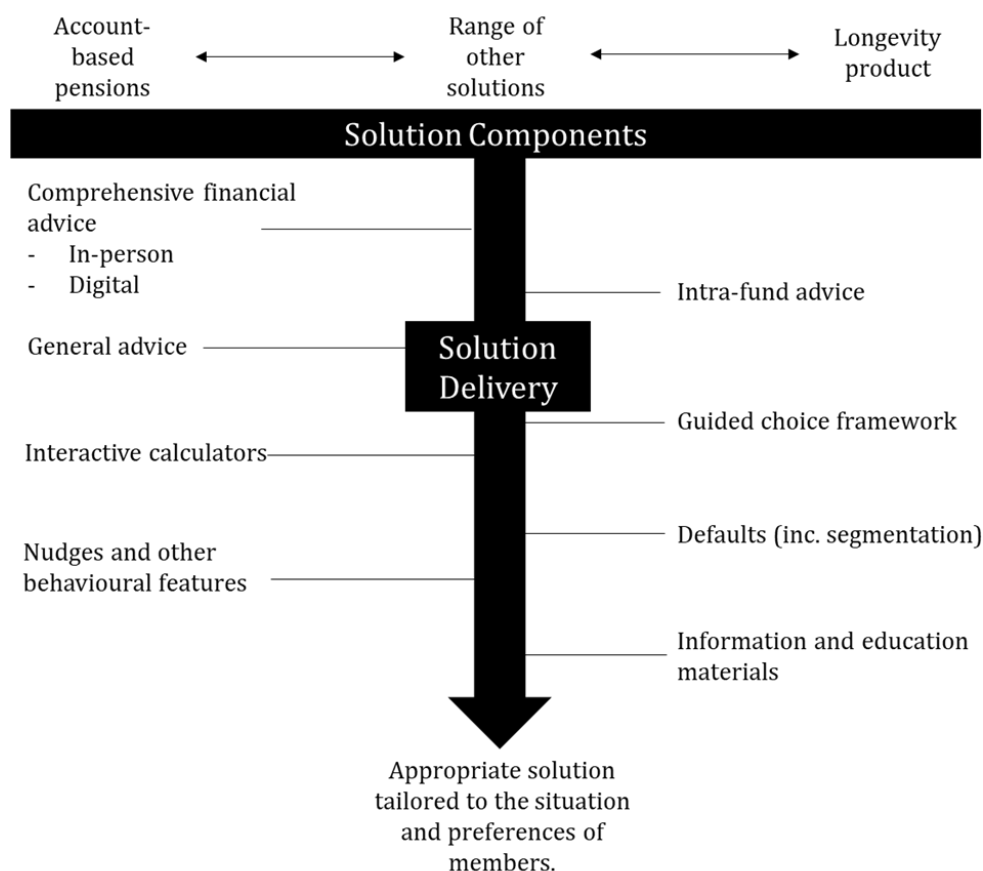


Figure 1: The “Retirement Challenge” (The Conexus Institute).

Structurally, the major components of the retirement industry, traditional financial advisers and super funds, face impediments to providing high quality retirement support to consumers. We use Table 1 to explain the reasons we believe this is the case.

	‘Traditional’ Financial Advice Industry	Superannuation Funds
Product Solution	<ul style="list-style-type: none"> • Commonly bucket approach • Limited use of longevity risk products • Unprepared for future products • Lack of stochastic systems to determine appropriate blend 	<ul style="list-style-type: none"> • Likely to be well-placed (in time) • Likely an ABP and a longevity risk product (but own solutions not an APL) • Systems to determine appropriate blend
Engagement Capability	<ul style="list-style-type: none"> • High engagement (ensured by self-selection) and face-to-face delivery model • Personal circumstances can be identified 	<ul style="list-style-type: none"> • Hesitancy to provide personal financial advice and collect and use personal data • Solution at large scale naturally limits depth of insights

Table 1: Assessed industry structural ability to provide high quality retirement solutions to consumers (The Conexus Institute).

As described in Table 1 our assessment is that the technical abilities relating to product (understanding and blending increasingly complex products based on longevity pooling) will be stronger at super funds. To our observation most financial advisers have not adopted the systems and training to assess and account for these products. However, the opportunity for high quality engagement clearly resides with financial advisors. This is challenging for super funds as they are directed by the Retirement Income Covenant (RIC) to account for age pension payments in the formation of retirement income strategies, and this requires identifying personal information to assess age pension eligibility.

The product solution component of Table 1 faces additional challenges: identifying the best solutions. Financial advisers will find it difficult to compare and assess a complex range of heterogenous solutions. The strategy for super funds will almost certainly be to use their own products. At a regulatory level there are no frameworks for assessing and comparing retirement solutions, which is understandable given the principles-based nature of the RIC. The anticipated broad range of product solutions and difficulty in comparing solutions in a multi-dimensional setting creates high likelihood of unintended obfuscation.

Will the traditional financial advice sector solve the retirement challenge?

Our working view is that the traditional advice sector will perform a modest role in meeting the retirement challenge. This view is underpinned by limited supply and business model considerations.

From a supply perspective, assume a start point of 17,000 advisers advising 2 million people. If laws and regulations changed significantly to reduce compliance-related workload by 20% (a generous assumption) then, assuming that all this reduced workload was applied to supply, this would create additional capacity for 500,000 new advice clients. In the context of 250,000 new retirees each year, this is insufficient.

Secondly, business model considerations mean that financial advisers generally target a wealth-based cohort where the monetary value of their service is viewed as worthwhile given the fees they charge.

In summary, many future retirees will not be recipients of traditional financial advice. A range of services need to be available and be offered at significant scale. We encourage the Review Panel to consider the workings of a broad spectrum of support services. At least some of these services need to be scalable, and they need to be able to co-exist without distinct legal / regulatory advantages.

Four possible solutions

In Table 2 we briefly introduce four candidate solutions to the challenge defined in the previous section (identifying a range of scalable support services). Each has merits and issues that would need to be further explored. A combination of solutions is most likely required.

<p style="text-align: center;">1. Fund-guided choice</p> <p>The ability for retirees to request that their super fund either recommend or select an option on their behalf.</p> <p>It is considered that some people would welcome a recommendation from their fund, but still want to decide for themselves. There may be some people who prefer their fund to choose an option for them.</p> <p>The delivery mechanism for fund-guided choice appears to be advice (likely with significant digital support), but funds appear hesitant to provide retirement advice.</p> <p>This was explored in detail in <i>“Ensuring all retirees find a suitable retirement solution”</i> and referred to in the Retirement Income Review.</p>	<p style="text-align: center;">2. Choice support</p> <p>A standardised tool that provides low-cost, tailored support to pre-retirees. The tool would be accessed through approved providers (initially, APRA-regulated entities and AFS-licensed financial advisers) and would provide protection via a safe harbour.</p> <p>The tool would standardise and streamline key elements of the retirement transition decision. Standardising these elements allows for the tool to be safely carved-out of many of the existing regulatory arrangements for ‘personal financial product advice’ that add to the cost and complexity of that advice.</p> <p>This was proposed in <i>“Retirement transition support that is safe by design”</i>.</p>
<p style="text-align: center;">3. Centralised government retirement services</p> <p>Various government support services be aggregated and re-coordinated into a central source of assistance for retirees. This includes Centrelink, MoneySmart, and ATO services such as the Your Super Comparison Tool. The re-calibrated service would provide online, phone and in-person services to support decision-making and implementation / administration.</p> <p>This would ensure that low-cost support is available to all retirees.</p> <p>This idea is detailed further in the submission made by Super Consumers Australia.</p>	<p style="text-align: center;">4. Retirement defaults</p> <p>Permitting super funds to provide retirement default solutions serves multiple purposes. It provides a considered solution for disengaged members, a solution for those who actively choose to elect the trustee-designed solution, and a reference point for members planning to make their own choice.</p> <p>Retirement defaults would have to go through an authorisation process. This represents an opportunity to set standards.</p> <p>A case for retirement defaults is made in <i>“Ensuring all retirees find a suitable retirement solution”</i>. Retirement defaults are supported in the submission made by Super Consumers Australia.</p>

Table 2: Four candidate solutions to the challenge of providing retirement support to Australians.

2.2. Quality Financial Advice

As outlined quality advice is difficult to define and hard to identify and measure.

We first consider how quality financial advice could be defined. We take a lead from the medical and legal professions. The [AHRQ \(Agency for Healthcare and Research Quality\)](#), part of the US Department of Health and Human Services, observes that

“The Institute of Medicine defines health care quality as “the degree to which health care services for individuals and populations increase the likelihood of desired health outcomes and are consistent with current professional knowledge.””

The [Legal Service Consumer Panel](#) in the UK states

“Quality in legal services means combining up-to-date legal knowledge and skills with good client care to deliver advice in a way that is useful. Whilst some aspects of good service are visible, consumers lack the expertise to judge technical matters and so focus on client care. They assume that legal advisors are competent and that someone is making sure standards are being maintained.”

Through this lens we reflect our framing of the features of quality financial advice in Figure 2.

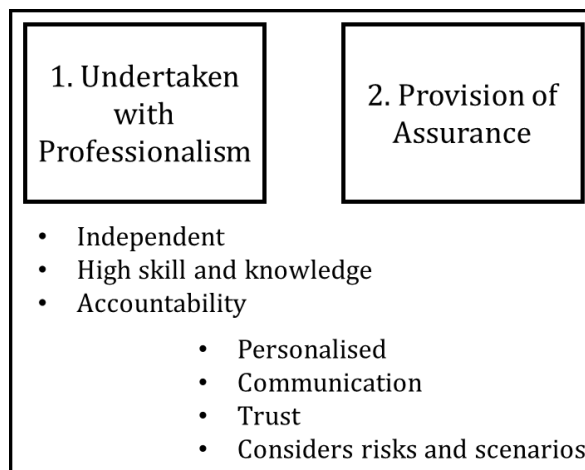


Figure 2: Framing of quality financial advice (The Conexus Institute).

In Figure 2 we frame quality through two central features: the professionalism with which advice is undertaken and the provision of assurance. We consider some characteristics which apply directly to the professionalism feature and a range of characteristics which apply to both features.

When we consider the characteristics in Figure 2 it becomes readily apparent that measurement of quality is difficult. We also consider that in some cases a consumer’s assessment may not perfectly reflect all elements of quality; in this respect it may be an input. This issue has been recognised in the measurement of quality in the healthcare sector (e.g. [Hanefeld, Powell-Jackson, and Dina Balabanova \(2017\)](#)).

Some of these characteristics can potentially be underpinned by law and regulation, such as commission bans, education conditions, and process requirements. This ensures a baseline which may or may not ensure high quality. Other areas are more difficult to assess and measure; in many cases the assessment process would need to be qualitative.

A final cautionary tale on measurement: the Your Future, Your Super performance test. This was designed to improve performance accountability of the superannuation sector and provide consumer protection, undoubtedly good intentions. However, the design of the test has been highly contentious to the point where it appears to constrain super funds from maximising member outcomes. The Conexus Institute has always maintained that an approach which applied multiple assessment techniques (in this case multiple metrics and a qualitative overlay), would have delivered better outcomes.

2.3. Accessible Financial Advice

We believe demand for financial advice is very hard to identify. When it comes to the topic of accessible financial advice, we start with a broader question: “who would benefit from improved guidance and advice?” We believe many people would. If we return to our retirement case study, there are 250,000 people each year who face a complex and daunting financial decision.

Whether they want financial advice or not is a separate issue. [Warren and Bell \(2021\)](#) identify five ways a consumer may seek to engage with their retirement finances. This is reproduced in Table 1.

Type	Preferred mode	Decision frame	Who would identify an appropriate solution
1. Fully-advised	Seeks comprehensive financial advice	Fully-advised	Adviser
2. DIY-active	Wants to choose by themselves, perhaps with some assistance	Self-directed choice	Retiree
3. DIY-reactive	Would welcome a recommendation from their fund, but wants to decide for themselves	Fund-guided choice	Fund and Retiree
4. Guided	Would prefer their fund to choose an option		Fund
5. Disengaged	Does not engage at all	Fund selection	Fund

Table 1: Retirement solution choice – A spectrum ([Warren and Bell \(2021\)](#)).

A recent survey by [Frontier Advisers \(2022\)](#) broadly aligns with the categorisations in Table 1, excepting the disengaged which cannot easily be captured in this style of survey. The focus of the Frontier survey is to explore what assistance members would like from their super fund.

Preferred mode	Survey response
Refer me to a financial adviser to advise me (for a fee) on a suitable retirement income solution for me	9%
Leave it to me to choose a suitable retirement income solution for me	20%
Recommend a retirement income solution for me	21%
Assist me to choose a suitable retirement income solution for me	50%

Table 2: Survey response: “When I retire I would like my fund to...” ([Frontier Advisers \(2022\)](#)).

Super Consumers Australia (2021)⁴ identify three segments of financial engagement:

- Disengaged: 38%
- Engaged delegators: 25%
- Engaged DIY: 37%

In this context we can see demand for a broad spectrum of services ranging from information right through to comprehensive personal financial advice. The demand for a financial adviser is unclear: on one hand, consumers may not be aware of financial advisers and the services they

⁴ *Retirement Income Standards*, Super Consumers Australia, February 2021. Final version forthcoming.

provide; on the other hand consumers may not be aware of alternatives to financial advisers such as digital advice services etc.

Though not an explicit consideration of the Quality of Advice Review, we do raise concern about disengaged retirees. Retirement defaults may serve to protect disengaged members but are presently not supported by the necessary safe harbor legislation. The case for retirement defaults to be an option for super fund trustees is explored in [Warren and Bell \(2021\)](#).

2.4. Types of Advice

Framing of advice types

Rather than focus on the labels attached to advice, we focus on the spectrum of activities. This is framed in Figure 3 (for which we acknowledge Pamela Hanrahan).

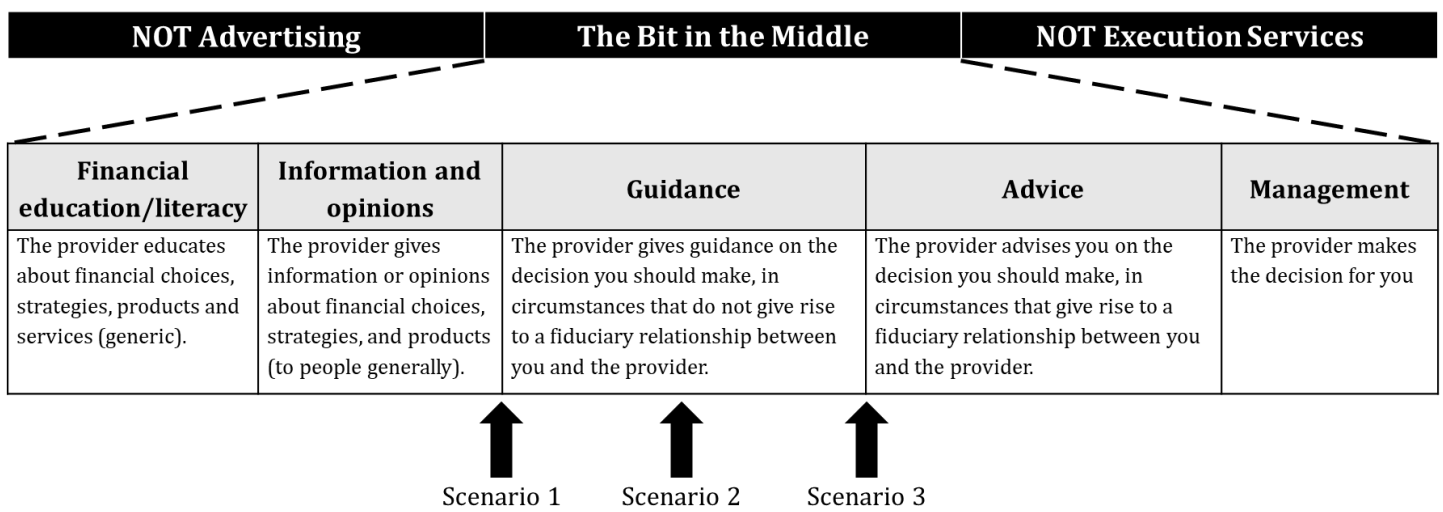


Figure 3: Breakdown of spectrum of financial services, with three possible scenarios for advice licensing.

Along the spectrum provided in Figure 3, the key consideration for the Quality of Advice Review is where to draw the “line in the sand” around what should be licensed financial advice. The difference between Scenario 1 and Scenario 3 is significant. Scenario 3 represents a tighter definition of advice with emphasis on the formation of a fiduciary relationship. Under Scenario 3 consumer protections from poor guidance come from AFCA (where relevant) and through law in the form of misleading and deceptive conduct.

Scenario 2 represents a difficult outcome for industry, regulators and ultimately consumers. There would remain ongoing uncertainty and confusion around what is advice and what isn’t. This would limit the amount of investment that would go into distinguishing the difference between guidance and advice.

Under the framing we have just outlined, the character of advice is whether a fiduciary relationship underpins the recommendation.

General advice would fall into ‘Guidance’ on Diagram 3. The situation would be more complex if a fiduciary relationship already exists. While technically this could remain guidance, a client may interpret guidance as personal advice, especially if the guidance contains a recommendation.

2.5. Intra-Fund Advice

It is difficult to understand why intra-fund advice exists. There must be more of a legacy story than what is provided in the Issues Paper. Perhaps there is a legislative reason linked with MySuper. As it stands intra-fund advice appears to facilitate the mass provision of limited advice without the obligation on funds to compare their products against others in the marketplace; this warrants clarification.

Without the product comparison piece intra-fund advice facilitates vertically integrated super funds. We discuss vertical integration in the next section, advocating for a thorough consideration of its merits and challenges.

Super funds create significant (likely far greater) cross subsidies from other activities such as member fee structures and insurance arrangements. In the absence of intra-fund advice trustees would need to determine the advice services they want to provide to their members and an appropriate pricing structure, through a lens of benefit to members, commercial and risk considerations. If funds aren't required to compare their products against those of other funds, then the decision is distorted: commercial benefits (retention) are higher and cost and risk both reduced. The net benefit to members is likely positive based on the assumption that they would not switch providers.

2.6. Digital Advice

The Conexus Institute has been exploring digital advice as part of its research into scalable solutions to support people entering retirement. We make a range of observations.

The first is that the foundation of digital advice is single issue advice. Providers of comprehensive digital advice have managed to bring together multiple single issue advice components. The nature of the delivery of comprehensive advice is quite different. Where a financial adviser can listen to a client's life story and identify areas to focus in on, the digital advice process begins with a digitised fact find. The limitations of comprehensive digital advice are directly related to the number of single-issue advice components incorporated into the software.

Retirement is one of the more difficult digital advice components. A recommendation based on deterministic (expected) outcomes is inadequate. To manage the range of outcomes associated with investment returns and mortality outcomes requires a stochastic framework. Software needs to account for the means tested age pension (most software does) and the increasing range of longevity products. We know of no digital advice platform that meets all these criteria. That said we are also unaware of any financial advisor software that meets these criteria (as per Table 1) as the software is not available to support them.

Digital advice providers struggle with the product comparison piece. They generally do not undertake a comparison of products and recommend what they consider to be the best. Instead they often make use of fund ratings or run passive solutions.

It is not surprising that financial advisers haven't blended digital advice services into their businesses. The difference between the two are significant: business model and culture, advice outcomes, and risks. We think that is likely to remain the case.

Digital advice models have more potential inside super funds. Some of the digital modules sit outside topic areas for intra-fund advice (retirement advice being a notable example), which potentially creates the challenge of product comparison.

The Conexus Institute is currently actively engaged in a survey which explores issues such as awareness, knowledge, and barriers to using digital solutions. When the results are available, we will update the Review Panel if any interesting results come to hand.

Calculators are a special and difficult case. The continuum between calculators and digital advice is not necessarily smooth. Consider the case of two retirement calculators:

- Calculator 1 projects retirement income based on a simple formula which assumes an account-based pension, constant returns, and a fixed age of death.
- Calculator 2 projects retirement income based on a complex optimiser which considers a range of retirement products, variable returns, and an unknown age of death. The underlying mix of products, investment allocations and drawdowns are included as output.

Where Calculator 1 might be clearly viewed as guidance, is Calculator 2 better guidance or is it financial advice?

The characterisation of a fiduciary relationship is interesting when it comes to the digital environment. The formalisation of asking for an opinion or recommendation may be behaviourally different to the way someone enters a fiduciary relationship with a financial adviser.

2.7. Conflicted Remuneration

The Conexus Institute is of the view that a strong professional advice industry is one that is free of conflicted remuneration. Reflected through Figure 2 we believe the absence of conflicts ensures greater professionalism. It will engender greater trust, improving the assurance experienced by consumers.

Conflicts created by vertical integration have some similarities to those embedded in conflicted remuneration. There are benefits to vertically integrated business models, some of which accrue to customers and some to business. While the benefits to business are not as explicit as commissions, there are still first order benefits (i.e. revenue) and second order benefits (such as retention); each represents a financial benefit.

The Conexus Institute previously called for vertical integration to be included in the Review⁵. Our interpretation of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry is that Justice Hayne called for vertical integration to be reviewed at an appropriate time.

Vertical integration embeds a conflict of interest. By calling for a nuanced review of vertical integration, we are calling for the concept itself to be reviewed: both its benefits and detractions.

Returning to our retirement challenge case study, some of the leading candidate solutions are based on vertical integration. This includes expansion of intra-fund advice to include retirement

⁵ [“Vertical integration needs a nuanced review”](#), Professional Planner (2022).

advice, and the aligned version of retirement choice support). It may be determined that vertical integration is necessary to deliver guidance and advice at a mass scale. It is difficult for industry to invest capital into business models if vertical integration is not clarified. It is difficult for policymakers and regulators to determine what other protections are required without being certain on the future of vertical integration.

2.8. Consent Arrangements for Wholesale Client and Sophisticated Investor Classification

It has always been difficult to understand why a consumer should automatically relinquish consumer protections based on their income or level of wealth. At a minimum there should be a requirement for a consumer to make an informed decision to opt into wholesale status.

We advocate for the consumer definition to be consistent with the AFCA definition.

2.9. Credit Advice and Financial Advice

We find it incongruent that there are separate licensing regimes for financial advice and credit advice. From a consumer's perspective we are certain they don't distinguish between these categories of finance.

One trend is that these issues of advice and debt guidance are becoming increasingly integrated at the point of retirement. More consumers are retiring with outstanding mortgage debt. And housing stock represents a source of capital and income for retirees. Professional advice for retirees will require two licenses.

3. Summary and Recommendations

The Quality of Advice Review will be difficult for panel members due to the morass of law and regulation, and the operating models that have developed as a result.

The Conexus Institute comes to the Review as an independent party focused on provision of financial support services to all Australians. Our specific focus is support at the point of retirement, a case study we carried through this submission. The scale of the retirement challenge (250,000 retirees a year) is significant and no matter the changes to reduce compliance obligations for financial advisers, other mechanisms will be required to support most of those retirees.

Achieving a legal and regulatory setting which facilitates provision of support while protecting consumers is a significant challenge for this Review.

In this submission we explore a range of areas and attempt to provide useful insights. We remain most concerned about the lack of consideration given to vertical integration. This is fundamental to the design of mass solutions required to support Australians. Exploring the issue removes uncertainty and facilitates investment.