

Submission in response to the Treasury’s *Quality of Advice Review*

Contents

| | |
|--|---|
| This Submission..... | 2 |
| OpenInvest’s Mission..... | 2 |
| Financial Advice and Managing Investments..... | 3 |
| Key Points..... | 3 |
| 1. The term “General Advice” | 3 |
| 2. The border between Personal and General Advice | 3 |
| 3. Fiduciary obligations and conflicts of interest | 4 |
| 4. Shelf-space fees | 5 |
| 5. Licensing of Accountants | 5 |

This Submission

We appreciate the opportunity to contribute our views in this submission to the Treasury's Quality of Advice Review. Our comments are limited to the area we are most focused on, which is how retail consumers invest money that they hold outside of Public Offer Super. We have set out the ways in which we believe the regulatory framework restricts the ability of the mass market of Australians to access relevant professional help in their financial lives and stifles innovation from providers who might be able to provide that assistance.

The Industry Structure

The current industry regulatory environment brings to mind two relevant aphorisms:

1. *The Perfect is the enemy of the Good* (Voltaire): Regulations are now so comprehensive and require such an extensive amount of work by licensed financial advisers to satisfy them, that personal financial advice is inevitably extremely expensive. Of course, it follows from this that only the already-wealthy can afford to access it. Indeed, access to financial advice has plummeted - with the latest data suggesting only 10% of Australians are currently receiving financial advice.
2. *Nature Abhors a Vacuum* (Aristotle): Inevitably, into this vacuum have sprung a large number of online solutions encouraging the mass market of unadvised Australians to try their luck at investing (gambling) via share trading, crypto, CFDs and/or options. Yet concerningly, all of the research undertaken in international markets shows time and again that the vast majority of retail investors do not succeed via their own trading.

To be blunt, we actually have the worst possible environment for the mass market of Australians; left to their own devices and bombarded with numerous expensive marketing campaigns by providers encouraging them to improve their financial situation by trading in different financial markets or investing in crypto-currencies.

I summed up my views of this environment in a recent article for the Stockbrokers and Investment Advisers Association (see [here](#)).

OpenInvest's Mission

OpenInvest is a Melbourne-based fintech investment platform that enables its partners to offer managed portfolios to investors, either via the OpenInvest marketplace or via their own online solution, alongside informative and engaging content. OpenInvest's offering is an investment platform; a technology, regulated financial product and operations infrastructure that can be deployed in multiple ways to reach retail consumers and give them access to professionally-managed investment portfolios managed by an entity they know and trust. OpenInvest Limited is the Responsible Entity of the OpenInvest Portfolio Service, an IDPS-like Managed Investment Scheme.

We founded OpenInvest in 2017 (although I began mapping out key precepts in 2016) to provide a safe, engaging, scalable and compliant online environment through which the mass market of Australian retail consumers could access professionally-managed investment portfolios from trusted and expert money managers. OpenInvest itself does not make investment decisions, instead we implement investment decisions made by such entities across any number of client accounts attached to their "model portfolios".

We believe *every* retail investor is better off with a managed, diversified investment portfolio, as opposed to trying to manage their own trading. If someone is able to obtain that via a financial adviser, well and good: we're not presenting an argument against advisers, or that every investor should use our solution or technology like ours. Rather, we aim to assist the 90% of Australians who are unadvised, to access a comparable level of investment expertise in the management of their money, via a lower-cost, online means.

Financial Advice and Managing Investments

I want to state something at the outset that bears explanation, as many people confuse these terms. Financial advice is not the same thing as managing investments: one can receive personal financial advice on a large number of topics completely unrelated to one's investment portfolio, whilst separately, one can invest into a professionally-managed investment portfolio of which one has not received personal financial advice and does not have an adviser. Unfortunately, the two are often conflated, and in fact, I would suggest such conflation exists in the very title and terms of reference of your review¹.

Key Points

Our key arguments for your consideration are set out below. In a way they are self-serving, however, a better way to think of them is not so much that we are promoting these arguments because some of them if implemented would help OpenInvest, but rather, that we founded OpenInvest because we believe in these arguments. I also want to note that my arguments are formulated via a *Law and Economics* worldview.

1. The term "General Advice"
 - a. The concept is fine and whilst it works in practice to provide the counter to personal advice, the term itself is confusing to consumers. We and our partners are able to offer our financial product via general advice in a logical, scalable and compliant way. However, no retail consumer who signs up for a managed portfolio via our product would consider that they had received "advice" or that they are "advised". A different plain-English term is needed.
2. The border between Personal and General Advice
 - a. OpenInvest offers no assistance to the consumer as to which model portfolio they ought to select; we provide plain-English information as to the objectives and mandate of each portfolio, describe the category of person for whom it might be suitable, and then leave it to the consumer to decide. In this way, we are offering our financial product pursuant to general advice.
 - b. There is nothing wrong with offering an online questionnaire to determine a recommendation for the consumer pursuant to personal advice, however, it does then come with an onerous initial and ongoing obligation upon the provider to be certain they have recommended the most correct portfolio, and that the portfolio remains the most appropriate.
 - c. It would be helpful if we were able to provide a digital "journey" containing various fact-based "nudges" or prompts to guide a person's decisions, without being at risk of

¹ I know that an individual who accesses online a professionally-managed investment portfolio has done so pursuant to a "general advice" offering, and yet such an individual would not ever think they have received "advice" or been "advised".

assuming the whole weight of fiduciary obligations that would then come with recommending a particular portfolio.

- d. I note that the FCA in the UK is exploring how such nudges might be given in a safe and compliant way, and that the SEC in the US has commented that it does not believe online “robo-advice” solutions are really set up to give fiduciary advice.

3. Fiduciary obligations and conflicts of interest

- a. The FOFA amendments were designed to address the perceived problems of vertical integration, by seeking to remove (or at least severely restrict) conflicts of interest in the provision of personal advice. In doing so, it has been made extremely difficult for major institutions to help the mass market of Australians with a set of pre-packaged, safe, secure investment solutions; because the rules are too difficult, risky and hence costly to navigate. I think I’m right in saying that we are the only country in the developed world where major banks do *not* help their retail customers with financial advice and investing (I note that our banks do help their wealthy customers to invest via their private bank divisions). That means either we are world-leaders, or we’ve got something seriously wrong at a policy level.
- b. I think the current legislative framework is misplaced; there is nothing inherently wrong with vertical integration (I don’t think it’s too dramatic to say that we would live in an entirely different world without the mass supply of goods and services that are only deliverable via the efficiencies that vertical integration brings). The solution lies in recognising a particular category of financial advice where the adviser and firm are not placed under the full burden of fiduciary obligations: where the adviser/firm are able to help consumers *within the confines of its particular investment product menu*, which itself might be influenced by vertical integration.²
- c. In the UK, advisers are required to openly categorise themselves as “independent” or “restricted” in some way – in a manner that provides clarity to the consumer.³ I would argue that the reason vertical integration in Australia led to poor outcomes pre-FOFA and the subsequent exit of the banks from offering personal advice to mainstream Australia, was not because of vertical integration itself, but because of a lack of clarity: consumers thought they were getting independent advice (at least in part) because the advice firm, investment platform and asset manager whose products they were invested into all had different names.
- d. We also cannot understand the basis for determining that certain forms of remuneration are conflicted where they are earned via general advice (see RG 246.32). If a personal recommendation has not been given, how does a fiduciary obligation arise such that regulation has a basis for interfering in fee arrangements between the provider and consumer?
- e. In passing I would highlight the bias towards inefficiency and poor consumer outcomes caused by the current regulatory presumption against conflicted remuneration. This is excellently described in [this article](#), however, in summary the situation is as follows.
 - i. In Scenario 1, an adviser is able to personally manage the investment portfolios of x number of clients and only earn an advice fee from each for doing so.

² I understand this may already be possible using various formulations of “scaled” advice, however, I think this is perceived as carrying its own risks.

³ See FCA website description [here](#).

- ii. If the adviser seeks to change each client portfolio, they must go through a cumbersome and costly process to do so, the result of which is that inevitably some clients are worse off than others, because their portfolios will not all be updated at the same time: the adviser cannot get appropriate compliance documentation to each client at the same time, and then confirmations from each client at the same time.
 - iii. In Scenario 2, the adviser's clients are invested via a model portfolio administered through a managed account investment platform. When the adviser decides to change client portfolios, they update the model through the platform's technology and the platform processes that change across every client subscribed to that model portfolio, whether that is 100 accounts or 100,000 accounts. The end-result is that every client's portfolio is always as it should be, and changes are effected for all clients speedily and more cheaply. Yet here, if the adviser seeks to charge a fee via the platform for managing the client's portfolio, it becomes conflicted remuneration. This can be addressed via disclosure and yet it's an illogical and inefficient bias to impose in the first place.
- f. The broader benefit in getting the policy right in this area is to enable technology to do more of the "heavy-lifting" for more Australians, freeing up the time of (the dwindling number of) financial advisers to focus on the particular issues that are relevant to each individual client.

4. Shelf-space fees

- a. The other aspect of the FOFA reforms that sought to address a perceived problem in the industry at the time of their passing, is the banning of "shelf-space" fees; fees paid by a product manufacturer to an investment platform. I cannot think of anything comparable in any industry - unless there is a natural monopoly involved. That is, where legislation intervenes in the proposed commercial arrangements between different parties in the supply chain. The authors of such provisions must have been working on the basis investment platforms exhibited natural monopoly characteristics, however, this is a fundamental misunderstanding. As evidence, one need only look at the reversal in fortunes of the largest platforms in the industry versus what were then challenger platforms at the time such provisions were passed.
- b. My suggestion is that these provisions be entirely removed.⁴

5. Licensing of Accountants

- a. In our view, accountants should be given much more scope to talk freely to their clients (in particular those with SMSFs) about their situation, without the need for an AFSL at all. Practising accountants are already "licensed", after all.

⁴ Just to be clear – it is not part of our business model to charge shelf-space fees, nor is there any plan to do so in the future. The way that our 'marketplace' solution is designed and hosted, is the result of our deliberate efforts to structure arrangements with our affiliate portfolio managers so that there is no ability for us to favour one over the other. This independence is highlighted to customers to whom we promote ourselves as being agnostic in the selection of investments through the service. We have restrained ourselves from being any other way in the PDS and disclosure documentation. Despite this, we don't believe the prohibition makes sense and feel that it stands to stifle bona fide activity and innovation in the industry.

- b. What should accountants be able to do and say with regard to investing? Firstly, if an accountant is seeking to manage investment portfolios, we agree they should require the same form of AFSL as a non-accountant offering that service.
- c. However, if they do not offer such a service - and the vast majority of accountants don't - then we believe accountants should be able to speak freely in order to express an opinion on the investing approach being adopted by the client without having to use a form of stilted language to ensure they are not perceived as crossing any lines and inadvertently giving financial product advice. Clients of accountants look to their accountants for such guidance, and are not helped by accountants feeling they are so constrained by the regulatory regime that they say nothing, potentially leaving such clients in extremely risky and dangerous investment portfolios.
- d. Accountants are free under the law as it stands to provide "factual information" to such clients, setting out various options they may wish to explore to obtain professional portfolio management assistance. And in fact, we have produced just such a fact sheet for accountants to use (see [here](#)). However, we have found in practice in discussing this issue with accountants there is a reluctance to entertain such a course for fear of "getting into trouble", despite the fact that they freely acknowledge the majority of their SMSF clients are self-directed in their investing and:
 - i. Many are invested in a highly concentrated, barely-managed portfolio of ASX large-cap shares; and
 - ii. Others are too busy to manage their portfolio such that contributions end up sitting in cash.
- e. What do we mean by accountants being able to speak freely on this issue? Merely being able to point out the risks a client is running leaving their SMSF portfolio as it currently stands, and being able to point them in the direction of various solutions the client may wish to explore.

We sincerely thank the Review Chair, Ms Levy, and the Treasury's Quality of Advice Review team, for taking the time to meet with us to discuss these important issues, and appreciate the opportunity to contribute to your review. If there is anything that we can do to assist, or if there is anything that you would like to discuss further, please don't hesitate to contact me directly.

Regards,

Andrew Varlamos

Andrew Varlamos

CEO and Co-Founder
OpenInvest.com.au

m: 0423 275 802

e: andrew.varlamos@openinvest.com.au