

THE FUTURE OF FINANCIAL ADVICE - GETTING THE BALANCE RIGHT

Financial Services is the largest industry in the Australian economy, contributing 10.6 per cent to GDP – more than manufacturing, more than mining and agriculture combined.

Financial Services has been the largest contributor to total economic growth over the past twenty years. Between 2000 and 2010 finance and insurance services contributed 14 per cent of Australia's economic growth. Compare this to the “booming” mining sector which contributed just 10 per cent to total growth.

We employ 400 000 Australians, not only in our major cities, but in towns and suburbs across the nation.

Today, I want to outline the Financial Services Council's vision for the future of financial advice.

In doing so I want to send a message that our industry embraces reforms that improve the professionalism, transparency and quality of financial advice.

But just as strongly as we support these reforms, we oppose anything that unnecessarily increases costs, reduces the availability and accessibility of advice to consumers, reduces competition and eliminates the basic business and consumer benefits of scale.

Ladies and Gentlemen, I want to start by outlining the benefits of financial advice to Australians. This week we released landmark independent research from KPMG Econtech that clearly demonstrates the significant value of financial advice.

The research shows that the true value of financial advice lies in its ability to change an individual's savings behaviour and encourage greater financial discipline.

The research analysed 3.4 million individual accounts over a four year period including FY06 and FY09 - two of the best and worst financial years in Australian history. It revealed that individuals with a financial adviser save an additional \$1,590 each year (after the cost of the initial advice) compared to a similar individual without a financial adviser.

On these results – and this is a conservative estimate based on a risk-free rate of return of 3% per annum:

- a 60 year old would save an additional \$29,000 on retirement;
- a 45 year old would save an extra \$80,000; and
- a 30 year old Australian would save an additional \$91,000 on retirement.

The Government has estimated the same 30 year old will be \$40,000 better off at retirement as a result of the introduction of MySuper.

So let's put this in perspective - the benefits of financial advice are more than double the savings in MySuper. And that's before the implementation of a single FoFA reform.

The KPMG Econtech research also shows that wealth creation is not the only area where financial advice delivers value. It revealed that individuals with a financial adviser were at least four times more likely to have life insurance cover.

The research shows that Australians who receive advice about their life insurance needs are more adequately insured, holding on average more than two-and-a-half times the level of cover of those who do not receive advice.

Ladies and Gentlemen, this research unequivocally shows the benefits of financial advice. It also demonstrates just why it is so important to get the balance right in the Future of Financial Advice, or FoFA, package.

Let me now turn to addressing the context of these reforms.

The Financial Services reform agenda provides our industry with a once-in-a-generation opportunity to re-establish, and in some cases establish for the first time, a relationship of trust with consumers.

For that reason it is critical that the reforms deliver the best possible outcomes for consumers.

It is also essential that given the high risk of unintended consequences, these reforms do not leave us with the perverse outcome that financial advice to ordinary Australians is more expensive and less available than it has ever been.

As an industry we have embraced the overwhelming majority of recommendations in FoFA.

From the outset we have endorsed the guiding principles for these reforms laid out by the then Minister for Financial Services, Chris Bowen. When announcing the reforms, he said:

- “Financial advice must be in the client's best interests – distortions to remuneration, which misalign the best interests of the client and the adviser, should be minimised; WE AGREE.
- In minimising these distortions, financial advice should not be put out of reach of those who would benefit from it.” WE AGREE.

This framework clearly recognises that there is a balance that needs to be struck.

Today I want to outline how that balance can be struck and how we can have a reform agenda that ensures:

- Greater power in the hands of consumers;
- Transparency in the cost of advice for consumers;
- A higher quality of advice; and
- Higher standards and professionalism for financial advisers.

And in doing so, ensure that financial advice remains accessible and affordable for the millions of Australians who need it most.

The FoFA reforms centre on four key proposals:

1. The introduction of a Best Interest Fiduciary Duty for financial advisers – which we see as the foundation;
2. Scalable advice;
3. Removal of conflicted remuneration; and
4. Volume related payments.

These measures must be viewed as a package rather than just a collection of individual measures. Their combined impact, as well as additional measures announced in the 'Stronger Super' reforms, will transform financial advice – changing the way advice is provided, by whom and how it is paid for.

As a result, the reforms will also have a significant impact on the structure of the industry and the competitive landscape. It is therefore critical that the Government assess the combined impact of the measures rather than consider each on a stand-alone basis.

Best Interest Fiduciary Duty

The requirement that financial advice given to Australians must be in their best interest is at the heart of the FoFA reforms and has been universally embraced by the industry.

The introduction of a statutory fiduciary duty, which will be subject to a 'reasonable steps' qualification, is particularly welcome because it provides the foundation upon which the financial advice industry can truly establish itself as a profession.

The legal requirement for advisers to place the best interests of their clients ahead of their own will build consumer confidence and trust in financial advisers within the community.

Financial advice will only become a profession, trust will only be created and consumers will only have confidence if the best interest duty applies across all forms of personal advice – be it through a licensed adviser, an accountant or super fund trustee.

There can be no exceptions.

We have made it clear in our discussions with the Government and Treasury that the best interest fiduciary duty must be drafted in clear and simple terms. Legislative uncertainty – which must be avoided at all costs - will only work against the objectives of these reforms.

I want to acknowledge the ongoing efforts of the Financial Planning Association to elevate the advice industry to a profession. The changes they announced in November last year were significant and represent another milestone for the industry on its journey towards professionalism.

This new direction is fully supported by the Financial Services Council and I congratulate Mark Rantall and the FPA Board for their commitment to higher standards and quality.

Scalable advice

The Government's package also proposes measures that aim to facilitate simple and more affordable advice. This benefits consumers and the industry.

Australians need and deserve advice that is relevant to their personal circumstances – and tailored accordingly. Not everybody needs a comprehensive financial strategy on every occasion. And they don't always require a 100 page document substantiating the advice that is provided.

Scalable advice is about ensuring that more Australians only get the advice they want at the price they are willing to pay.

However the regulatory system has to date not readily facilitated the provision of scalable advice.

The Government has an opportunity in these reforms to ensure that licensed providers of advice can establish advice models that enable more Australians to access appropriate advice.

Consumers must be able to specify, limit or agree the scope of the advice they want, with the new best interest fiduciary duty applying only to that agreed scope.

The Government has proposed that the provision of more low cost advice can be delivered through the expansion of the intra-fund advice model.

The principles underlying this approach are in direct conflict with the objectives of FoFA. Expanded intrafund advice will:

- See the cost of advice cross-subsidised – that is paid for by members who don't receive advice and have no ability to opt-in or opt-out;
- Rather than unbundling advice costs, actually sanction hiding advice costs inside the total cost of the product;
- Lack transparency;
- Eliminate consumer control; and
- See the majority of members pay for something they don't receive.

In the Government's proposal, expanded intra-fund advice will be delivered by super funds on matters like transition to retirement and social security – areas that are far beyond the duties and expertise of super fund trustees.

Expanded intra-fund advice is the wrong answer and a poor substitute for the tailored, quality financial advice Australians need.

Removal of conflicted remuneration

Ladies and Gentlemen, a critical element of these reforms is the abolition of commissions paid on managed investments and superannuation.

The FoFA package builds on the reforms announced by the Financial Services Council, then IFSA, in the 2009 Superannuation Member Charter.

The Charter put consumers in control by giving them the choice and flexibility to agree upfront with their adviser the cost of the advice and how it will be paid for. Importantly, under our Charter the consumer has the ability to opt-out and cease payments to their adviser at their discretion and at any time.

From 1 July 2012 commissions and other conflicted remuneration structures will be banned and all financial advisers will have a statutory duty to place the interests of their client ahead of their own.

It will be a new world of financial advice.

Opposing annual opt-in

Given this significant strengthening of the current regime, it is difficult to understand the push for an annual 'opt-in' renewal requirement for financial advice.

We believe annual 'opt-in' is bad public policy. It is short-sighted, it undermines the strength of the FoFA reform package as a whole and provides weaker consumer protection.

Instead, the FSC proposes a renewal framework for financial advice that operates in the best interests of consumers. We advocate a three year renewal, where consumers can opt-out and cease their payments at any time.

This approach has significant advantages over annual opt in:

1. It puts complete control in the hands of consumers;
2. It won't drive short-termism; and
3. It reduces the administrative burden on small business whilst retaining the highest consumer protection.

Additionally, we propose that consumers must receive at least an annual statement from their adviser outlining fees and services over the prior 12 month period and for the following 12 months.

Ladies and Gentlemen, FoFA's proposed annual opt-in will actually reduce consumer protection. Locking in a consumer over one year is inferior to allowing them to walk away at any time over a three year period.

Annual opt-in will result in financial advice skewed towards short-termism. This is exactly what advisers have to constantly battle against when communicating the value of advice to clients. This will create a 'fast food' style advice industry - one that provides "McDonalds" advice and churns through customers as quickly as possible.

Many of Australia's 16 000 plus financial advisers are small businesses. This is an element of the industry too often forgotten or ignored. The reality is that many financial advice practices are local businesses employing people and creating wealth in rural and regional Australia.

To burden these small businesses with an additional and unnecessary layer of regulation that does not enhance consumer protection will increase the upfront cost of advice and force many small advice practices out of business.

As I said before, an annual opt-in requirement is quite simply bad public policy. It is counter to consumers' best interests and will send the industry back in time to when the emphasis was on sales rather than professionalism.

So ladies and gentlemen, I find it amusing, to say the least, how the most vocal supporter of opt-in – and loudest opponent of opt-out - the consumer group CHOICE deals with its members.

"To keep your membership going we'll debit your credit, charge or debit card automatically every 3 months until you tell us to stop."

As they say, people in glass houses...

Volume related payments

Ladies and Gentlemen

The final major pillar of the Government's FoFA reforms is the proposal to ban all volume related payments.

The premise put forward by the Government is that ALL volume related payments conflict advice. But it is more complicated than this simple statement implies. It is by far the most complex aspect of the reforms – and also potentially the most damaging – not just to the industry, but most importantly for consumers.

It is a minefield of unintended consequences.

Let me make the Financial Services Council's position clear from the outset:

- We do not advocate the status quo;
- We want volume related payments that distort advice banned; and
- We want volume related payments that provide consumers and the industry with the benefits of scale to continue.

Ladies and Gentlemen, blanket banning of all volume related payments will result in significant distortions in the market. It is lazy public policy devoid of sound and detailed analysis. A blanket ban simply assumes that all volume related payments are evil and in doing so sacrifices genuine savings currently enjoyed by consumers.

The proposed ban will see major structural disruption to the Financial Services industry. This disruption will almost certainly lead to consolidation. This consolidation will benefit the biggest players who are in the best position to make acquisitions.

This will mean less choice for Australians looking for advice and will stifle innovation and reduce competition throughout the industry.

A blanket ban on all volume related payments will drive up the cost of investments and advice without delivering any benefits to Australian investors. In fact, it will result in Australians losing many of the benefits of scale they enjoy today.

These scale benefits exist in mining, manufacturing and agriculture, just as they exist in financial services. The existence of scale benefits in the financial services industry is no different to those in every other industry.

Ladies and Gentlemen

We do not advocate the status-quo. Instead we propose that payments that DO NOT create bias but enable Australians to benefit from scale - by paying less for investment and advice - should remain.

The FSC supports a product-neutral framework that addresses real and perceived conflicts, without sacrificing scale benefits that flow to consumers.

The product neutral framework ensures advisers are not influenced by volume related payments to select a particular platform with which to manage client monies, or a particular product in which to invest client monies.

This balance is achieved by prohibiting:

- Preferential payments which increase access or visibility on a platform or approved product list;
- Adviser remuneration schemes which are based solely on sales volume or which are biased towards the placement of business in a specific product or platform; and
- Volume related payments from fund managers directly to licensees or advisers.

These payments have the ability to distort the provision of advice, are not in the best interests of consumers and should not be allowed in a world where advisers must meet a fiduciary duty.

By eliminating these distortions the Government can achieve the highest level of consumer protection whilst ensuring consumers continue to benefit from scale discounts in the form of lower investment or advice costs.

Deductibility of advice

Ladies and Gentlemen, we are very encouraged by the Government's fundamental belief in the important role that financial advice plays in the community and its support for a growing and thriving advice industry.

In addition to boosting individual savings, financial advice plays a role in increasing national savings and growing the economy.

The KPMG Econtech research also found that if an additional 5 per cent of Australians received financial advice, national savings would increase by \$4.2 billion (or 0.3 per cent of GDP) by 2016-17.

I call on the Government to continue to act in the best interests of all Australians and increase the affordability of financial advice by making the cost of advice tax deductible.

Tax deductibility will create a simple, level playing field that gives consumers certainty and will remove the significant distortion that arises from the current taxation treatment of fees paid for financial advice.

Today, the cost of financial advice can be tax deductible if it is paid for on an ongoing basis, but not if advice is paid for on an up-front basis. With the move to fee for service Australians who choose to pay for their advice upfront will be disadvantaged.

It would be an unfortunate outcome of these reforms if the move to fee for service resulted in higher advice costs for consumers.

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