

Future of Financial Advice Reforms

When the Government announced it was to lead a review into the financial services industry last year, AXIS was encouraged. In our opinion, the reforms will provide a stronger statutory framework which benefits investors and advisers.

One year on and, after much consultation with industry, the proposed Future of Financial Advice (FOFA) Reforms were released on 28 April 2011. The aim of FOFA is to protect consumers, restore confidence in the advisory system and improve the quality and accessibility of advice. At the heart of these objectives is the removal of certain remuneration structures and ensuring advice is more affordable for more Australians.

In a nutshell, the Reforms propose the following:

1. A fiduciary obligation requiring advisers to act in the best interest of their client when giving personal advice;
2. A prospective ban on upfront and trail commissions for individual and group insurance within super;
3. A prospective ban on conflicting remunerations, including commissions, volume-based payments, "soft dollar" benefits of \$300 or more and rebates;
4. A prospective requirement for clients to opt-in or renew their financial advice agreement with their adviser every two years;
5. The introduction of "scalable" advice which is limited advice in one area only, such as helping members choose the right super fund, insurance cover, tax issues, etc;
6. The exclusion of basic banking products (eg savings accounts, travellers cheques) from the conflicted remuneration and best interest duty requirements.

On the whole, the financial services industry has embraced these reforms. However, some of the proposals have led to heated debate from industry. With an implementation date of 1 July 2012 and 2013, industry is using the coming months to voice their concerns and advocate change. So, let's take a brief look at which proposals are getting the green light and which ones are causing red.

The positives

1. Best interest of client

Any good financial adviser lives and breathes the mantra of acting in the best interest of his/her client. For most, it's a fundamental ethical code. However, moving this fiduciary understanding from an obligatory to a statutory requirement will provide consumers with greater protection from inappropriate product recommendations and potential conflicts of interest.

2. Scalable advice

The introduction of scalable advice has also generally been embraced. Not every person seeking financial advice wants or has the money to spend on a full financial plan. Providing limited advice on specific areas will, hopefully, encourage more people to seek advice about their financial situation. And, this is important for the long term financial benefit of all Australians. In fact, if findings by the Financial Services Council are anything to go by, the sooner Australians obtain quality financial advice, the better off the country will be.

The four year independent study¹ assessed 3.4 million individual accounts to determine the "true value" of financial advice. Overall, the research showed that the true value of financial advice is its ability to change savings' habits. It also revealed the following:

- those with a financial adviser saved an extra \$1,590 pa compared to those without an adviser;
- a 30 year old would save an additional \$91,000 on retirement – more than double the projections for a 30 year old in MySuper;
- those with a financial adviser were at least four times more likely to have life insurance and to be more adequately insured than those not receiving advice.

¹ KPMG Econtech, Research into the true value of financial advice, 2011, commissioned by the Financial Services Council.

3. Ban on conflicting remunerations

This proposal seems almost superfluous, with many in the industry having already moved to charging fee for service or planning to do so.

The negatives

The biggest bones of contention with the proposals revolve around the bans on insurance commissions and the opt-in proposals.

1. Insurance commission bans within super

According to Craig Meller, Managing Director, AMP Financial Services, the banning of commissions on insurance is confusing, as it's not obvious which problem it's addressing. Meller believes that the proposal is "ineffective because it will inevitably exacerbate Australians' chronic level of underinsurance." He further adds that this reform could have the unintended consequence of burdening taxpayers to fund the social costs of underinsurance.

MLC and NAB Wealth agree with the underinsurance argument. "Insurance is a...different product to investments and applying a ban on insurance commissions inside super will have many consequences, not least of which could be a reduction in the number of Australians who have adequate insurance cover."

Executive Director, Peter Johnston from the Association of Independently Owned Financial Planners (AIOFP) also questions the motive of this reform stating that any long term impact due to the commission bans would be minimal on premiums. "Unless insurers reduce the overall premium costs to consumers to reflect the abolished commission component, the banning strategy will be meaningless. If the current \$1.4 trillion underinsurance problem occurred in a commission environment, what is going to happen in a commission vacuum?" he queries.

2. Two year opt-in

For many financial advisers, this proposal seems to fly in the face of sound financial advice. With super being a long term investment and the nature of advice focussing on long-termism, the proposal appears nonsensical.

Zurich's Chief Executive, Colin Morgan believes this reform is counter-productive to the Government's objective of greater accessibility to advice. According to Treasury, this reform would cost a small advisory firm \$50,000 pa to run. Morgan argues that this significant and additional annual cost would need to be offset somehow and "consumer demand for advice is highly price elastic."

The Financial Services Council agrees, believing that this burden could drive many of the rural and regional advisory firms out of business.

If these arguments weren't enough, Chief Executive of the Association of Financial Advisers, Richard Klipin, offers more food for thought. Klipin believes that the two year opt-in could inadvertently lead to advisers specialising in particular types of clients, creating more "specialists" than "generalists". "We'll end up with a whole bunch of Australians not getting advice because it's not practical for businesses to service that niche," he says.

For a copy of the FOFA information pack, visit www.treasury.gov.au

Sources:

AMP Financial Services
Association of Independently Owned Financial Planners
Financial Services Council
MLC
Money Management
Zurich Life and Investments

www.axisfg.com.au

Feel free to contact your adviser with any questions about this edition of Super Focus

Phone 08 9426 5800 Fax 08 9426 5850
Freecall 1800 111 299 Email advice@axisfg.com.au

