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How ASIC is thinking about advice

Not the same old song

Ben Moffatt

On 29 November 2019, Australian Securities and Investments Commission (ASIC) deputy chair Karen Chester delivered a speech, 'Consumer outcomes: A truth universally acknowledged', at the Australian Institute of Company Directors Leaders' Lunch. Her speech outlined a change in ASIC's approach to consumer protection and offered many considerations for consumers, businesses and the broader community in financial services.

The speech drew upon the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), previous studies conducted by ASIC and collaborations with other financial bodies.

The message was quite clear in that ASIC will not be lessening its involvement any time soon, but will be increasing its industry presence with a slightly different approach. Interestingly, the theme included various references to disclosure, but from the perspective of over-reliance, and confirmation that it does not excuse bad advice.

There were 75 case studies from the Royal Commission totalling approximately $790 million in remediation costs for more than 1.2 million consumers, driven by poor outcomes including credit insurance, add-on insurance, fees for no service and deficiencies in financial advice.

Four lines of defence were referenced in the deputy chair's speech, namely:

- public policy
- the consumer
- firms and their directors
- the regulator.

All of these elements were seen to be playing a part in the delivery of fair outcomes to consumers. This paper examines the pertinent points of the speech in relation to providing advice, and offers some guidance on what can be done to ensure obligations are met.

Public policy

The first point addressed was the exceptionalism identified in the financial services industry by commissioner Kenneth Hayne. It was argued that it had drowned out the consumer voice. It is ironical that the very people it is meant to serve are the ones who suffer most, and the different treatment of institutions and some representatives of the financial services industry became somewhat normalised in Hayne's view. The process of rebuilding will take some time. However, as we move towards a new normal, hopefully the industry and its professionals will seize the opportunity with both hands and become heavily involved in a change for the better.

The second point mentioned regarding public policy was disclosure. Importantly, disclosure has limitations, along with the dangers of over-reliance on it.

In mid-October 2019, ASIC and the Dutch Authority for the Financial Markets published a joint publication, Report 632 Disclosure: *Why it shouldn't be the default* (REP 632). This report highlighted the findings from over 10 years of case studies and demonstrated the repeated failings of disclosure itself.

ASIC argued that these failings had played a part in the poor quality of advice provided and the misguided industry belief that 'anything goes as long as you disclose'. ASIC's view is that disclosure is not equipped to handle the role that some professionals are expecting from it.

Perhaps the more concerning factor addressed by the deputy chair was the architecture within the system that requires the disclosure, and the businesses that rely heavily upon it for their activities. Advertising, sales, manipulation of trust and emotion, coupled with distribution and 'sludgy' products all compete for the consumer's attention. Moreover, the disclosure documents are rarely read and understood. In October 2011, ASIC released Regulatory Guide 168 *Disclosure: Product Disclosure Statements (and other disclosure obligations)* because disclosure is a necessary part of the system and overall client experience. However, it does not protect against, or offer compensation for, poor advice.

ASIC research conducted in 2011 was also cited, as it uncovered a large gap in the quality of the advice and clients' perception of the advice. From 33 files, it was found that 86% of clients viewed their advice as 'good' and 81% trusted their advice 'a lot'. Later, assessors and a 12-person reference group found 3% of the advice to be 'good', 58% to be 'adequate' and 39% 'poor'. This is another indicator that disclosure cannot solve the current issues facing financial products and services.

Disclosure can also backfire, and this was evident in the findings. When 'bad' advice was provided by a conflicted adviser, 81% agreed to the advice when the conflict was disclosed. When this conflict was not disclosed, only 53% agreed to the advice. Disclosure is designed to arm the client with relevant information to assess and make an informed decision, but the study suggested that even though there was a conflict and bad advice was provided, it led to an increase in trust.

Tips and considerations

- Review the current relationships, affiliations and associations within the business and whether these are client-centric.
- Examine the level of reliance on disclosure and clarity of information provided.
- Review the processes and advice documents.
- Consider the products used in the advice and how these are linked to the client goals and objectives.

The consumer

Again, disclosure and employed practices in the provision of information was referenced by the deputy chair. In the past, the assumption was that giving the consumer the right information would make it easy for them to make an informed decision.

In ASIC's view, two main factors are contributing to the shortcomings, namely:

- clients' time and ability to read and understand the information
- product providers being 'opaque' in the provision of information for unnecessarily complex products.

The reliance on the public to understand the very products they are being advised upon has been too great in the past. The deputy chair alluded to the distribution of responsibility in this area and the need to shift it more to firms designing and offering products.

Financial literacy is an important piece of the puzzle, but it also has its limitations. REP 632 made reference to research suggesting that humans have limited capacity in the consideration of multiple high-level factors in decision-making. In fact, once the number reached two or three important factors, the differentiation of a 'good' and 'bad' deal became more difficult.

This further speaks to the firms and professionals in advice businesses to ensure that the client is at the centre of the process and the protection of these individuals is occurring. Tellingly, REP 632 found that 59% of people who were provided with either a product disclosure statement or a 'simplified' key fact sheet could not identify objectively the best of three home insurance policies.

American professor of behavioural science and Nobel Prize recipient Richard Thaler stated, "People are not dumb. The world is hard." There is a suggestion that a range of factors including the level and delivery of content within disclosure documents needs to be addressed, with only five of the 55 recommendations directed at the demand side of the equation (the client).

While financial literacy plays an important role, it is not the 'silver bullet' anymore. The recommendations from the Royal Commission highlight the need for responsibility to be shared between the client, firm and provider. This will place more importance on the delivery and explanation of the advice being provided and translating the information for the client.

Tips and considerations

- Review the advice documents with a view to shortening, removing irrelevant information and personalising remaining content.
- Include an executive summary.
- Think about engaging an external party to review advice documents.

Firms and their directors

The deputy chair mentioned three separate areas where 'blind spots' were evident, and the fact that each of these is interrelated. These are: gaps associated with empathy,

The quote

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gaps in evidence and gaps in incentives. The role which firms, directors and employees play in the quality of advice (whether good or bad) is clear and this is where the responsibility for change lies, not with the regulator.

Empathy

A November 2018 report titled *Conflicts of Interest and Disclosure*, authored by Cornell University associate professor of management and organizations Sunita Sah for the Royal Commission, addressed occurrences of a shift in empathy and ethics and highlighted how chain of events could result in a gradual creeping of thresholds whereby a firm, its directors and staff fail to see the situation from the client's perspective. This causes a shift in behaviour as the small incremental changes become commonplace and what was considered unethical previously now seems more palatable (for the business).

Evidence

An argument exists that data and systems have not kept pace with the complexity of the products which directly affect outcomes for clients, and the ability of the provider to identify the value of the product for their customers.

Relying on the 'voice' of their clients and determining what is important to them creates an opportunity for the development and use of new products and services to meet these needs. Instead of the self-servicing bias which has been evident in some behaviours, the question is now whether the overly complex and conflicted practices were worth it to begin with.

Incentives

Realigning incentives and interests is a necessary step in the recovery of the financial services sector. Further, the need for designing and offering products which deliver value and meet clients' needs, must be addressed. The deputy chair called upon firms to 'do the right thing' and address the areas of their practices which are overly complex and ultimately harmful to consumers.

Providing good advice is not hard, but it has become a more complex process due to several factors, including uncertainty. In reality, the removal of conflicting incentives and aligning strategies and products to clients' needs and objectives and placing them in a better position is the purpose of advice.

Tips and considerations

- Review internal processes and systems.
- Consider the client's position in the advice process and the effectiveness of the approach.
- Review the current relationships, affiliations and associations within the business and whether these are client-centric.

The regulator

Broadly, ASIC has decided to employ a two-pronged approach of enforcement and transparency to reduce regulatory burdens. The transparency aspect will be realised through the regulator's strengthened supervisory programs and initiatives such as Close and Continuous Monitoring (complaints and breach handling) and the Corporate Governance Taskforce. Transparency will be evidenced through feedback to corporates on findings and reporting these publicly. ASIC's view is that the firms and directors should view this as a valuable insight to how they are faring individually and against their competitors. The aim is to drive competition and better practices.

Naming names has also been included within the list of activities employed by ASIC along with the legislated Design and Distribution Obligations (DDO). We anticipate that these obligations should assist firms solidify their commercial value, with the outcome benefiting clients.

In closing, it was reiterated that there is an underlying need for the businesses to close the gap and do the right thing to ensure that client outcomes are better. This will hopefully reduce the regulatory burden and restore balance.

Tips and considerations

- Consider external assistance and a licensee review to provide a reference gauge.
- Review the internal business process and examine the protocols in place to address requirements.
- Consider whether a business is DDO-ready.

Conclusion

The majority of licensees, businesses and advisers we assist are doing the right thing from a broader perspective. It is rare that we encounter a situation where it is evident that a conscious decision has been made to circumvent statutory obligations, or the licensee, business or adviser has clearly placed their interests above the client's consistently.

The trouble is though, some of the occurrences are brought on by a blind spot or a change in structure or legislation that has not been fully examined or integrated into the business licensee's framework. It may be prudent to ponder systems and processes ahead in 2020 and the new environment. **FS**