Friday, May 20, 2016

Response to Consultation Paper 254 - Regulating Digital Financial Product Advice

Introduction

Ignition Wealth believes the development of a dynamic and strong digital advice sector is critical for the improved financial well being of the 75 percent of Australians currently without affordable access to competent independent financial advice.

We believe better engagement with personal financial decisions is an important step to bridging the financial knowledge gap and retirement funds shortfall, using technology as an enabler.

Our key suggestions

We offer two key suggestions to ASIC to restore confidence in the financial advice industry and re-engage a disengaged public:

1. Differentiate digital advisers as always under the “best interest” obligations to their clients - recognises the public’s view that all advice is personal.

2. Don’t dumb down digital advice; gold plate it! Greater reach and scale demands greater transparency, independence, testing and competence.

1. Advisers should always have a “best interest” obligation

ASIC has a limited opportunity to better differentiate digital advice licensees between those offering scaled personal advice to those simply providing general advice (factual information, financial calculators etc).

We believe the majority of digital advisers currently in the market are the latter and don’t have the all important “best interest” requirements.

This is a huge point of difference between financial or product information providers and advisers. Digital advice licensees should be constrained only to those that actually provide personal advice as the majority of the public expects such advice to be personalised - little current understanding of even the existence of different levels of advice (let alone the differences between them) cannot be ignored.

2. Greater reach and scale demands greater transparency, independence, testing and competence.

The inherent limitations of an online application preclude effective advice above a certain level of complexity (e.g. detailed SMSF advice, business succession etc.). However the rigorous ASIC-regulated licensing of even a scaled advice application gives it a legitimacy, of which the public demands a certain standard.

Licensed digital advisers are uniquely capable of delivering sound and effective financial information, education and advice to anyone, anywhere with internet access. Any deficiency or fault in such a service could cause widespread financial harm, harm that cannot be easily written off as a “few bad apple” advisers. Therefore we believe digital advice providers have greater responsibilities than traditional offline advisers including fee transparency, independence, fee for service charging and clarity on conflicts of interest - both real and perceived.

The vast majority of today’s large adviser networks share ownership with financial product manufacturers - a conflict that requires particular consideration.

We look forward to ASIC’s continued engagement on these points.

ASIC Highlighted Issues

We have also a view to two of the major issues ASIC have highlighted in this consultation paper:

1. Monitoring and testing C1
2. Best Interest Duty

1. Monitoring and Testing

The subjective ability of a licensee to assess integrity and continually test their algorithms against expectations seems to lend itself to some form of expert sign-off.

Instead of handing over the baton to actuaries only, we'd suggest ASIC extend the expert status to CFAs or other suitably qualified financial experts for example financial mathematics academics. Academic experts in quantitative finance, psychometrics, computer science etc. can provide an independent, but rich review on the quality of algorithms provided to retail clients.

We also envisage the engagement of academia as an opportunity to broadening the discussion about digital financial advice and leverage intellectual capacity at universities.

Further guidance on these expectations and standards would reduce the risk of erroneous or incomplete advice.

Based on existing regulation, AFS licensees need to keep clients records for seven years. We suggest that given the increased data storage capacity of a purely online offering, digital advisers are obliged to archive clients records indefinitely. This will raise the bar for new players and also present better service to clients.

On baseline algorithms

While some of today's robo-advisers may employ proprietary algorithms that do require sign-off from actuaries, most of the mathematics required for financial advice to the market has to do with standard present/future value calculations, compound interest projection and superannuation and retirement projections.

While there are many interpretations of these calculations and algorithms, all players in the market are missing some benchmark samples that are acceptable to the regulator - a gold standard so to speak on the financial basics.

Ignition Wealth long ago started its automated advice journey by studying early ASIC published spreadsheets of super projections and comparisons under the FIDO site. ASIC today continues to publish robo advice calculators of its own under the MoneySmart site.

We believe that the fastest way to bring some standardization across all solutions is for transparency all round with MoneySmart leading the way by publishing its algorithms and test scenarios and allowing robo-advisers to transparently expose their own versions and showing how they match the benchmark.

It is in everyone's interest that projections including investment and super projections and retirement drawdowns are starting on the same core foundations.

We would welcome an ASIC-lead move for transparency, exposing some of the baseline acceptable formulae such as those used on the MoneySmart site. It is essential that the industry accepts that while maths is important it is not the definitive view and certainly should not be painted with an aura of precision. It's not magic sauce!

The establishment of an independent board of technologists encompassing MoneySmart developers, mathematicians and independent programmers to monitor best practice and test the robustness of digital platforms and tools would provide a safety mechanism and increase consumer confidence. Following the example of the UK regulator we suggest the creation of a 'sandbox' environment where robo technologists can engage with AISC's team for review of new products during the development process.

In the end we all know the best advice for our clients is to help them understand the goals that are most important to them and understand the irrefutable truth that changing their behaviour by saving more and spending less is the most effective way of improving their financial lives. Technology enabling detailed financial modelling, online tools and calculators facilitate the enrichment of their financial life journey.

2. Best Interests Duty

The ability of digital advisers to comply with the best interest duty when providing scaled advice is, as mentioned above, different to the physical financial adviser. The big challenges we see are:

"Financially better off"

If a member of the public is cash flow better off but has no risk mitigation or is continually alarmed by the volatility of their investments, they may not, in their (or our) perceptions, be "better off".

Does the computational ability to produce a detailed cash flow for each of several complex options, ignore the qualitative aspects of the decision? For example, how does a digital adviser educate their clients to set the appropriate parameters (structure, asset class exposures, types of products etc.) for high-powered analysis enabled by technology?

Other factors to consider:

- Deciding whether to continue to use a particular investment fund after one of the manager's team leaves
- Group life versus retail life risk cover
- Evaluating:
    - a listed versus unlisted investment in a single participant in an attractive sector; versus
    - a specialist actively managed sector investment fund; versus
    - a passively managed sector specific index tracking fund
- Hybrid active life insurance cover versus separate trauma and TPD policies
- Personal or term loans versus lines of credit etc.
- Comfort levels with, and the degree of your client's understanding of, the more complex aspects of your financial recommendations.

Technology can provide fantastic scale and richness of qualitative information and muscle. This power needs to be used to help self-service clients make their own qualitative decisions around being "better off".

Product Assessments, comparisons and information
A way to standardise qualitative information is to standardise the source and form of at least high level product information and categorise financial products into fewer and better understood categories.

For example all Total and Permanent Disability (TPD) insurance policies available on market could have a steadily increasing minimum amount of standard features with product manufacturers able to add options as and when they desire or upon customer requests.

The public does not know common industry terms such as the difference between retail and group life insurance, much less the difference between activities of daily living and occupational incapacity. Understanding what minimum circumstances their life insurance covers them for (through their default superannuation at least) will reduce the expectation gap.

Examples of attempts to standardise rankings against certain criteria are available in every research house. One of the few standards available across different product providers is the life insurance research houses' policy score tables - qualitative assessments codified into a score out of 100.

If the minimum attributes of products do not at least match public perceptions and expectations, the advice industry will continue to suffer. Some minimum attribute ratings for investment products could include capital preservation bias (volatility vs market volatility), performance relative to risk (information ratio), manager alignment (high levels of co-investment and manager remuneration including future dated fund options) and investor alignment (low management fees with a high watermark performance fee). Bespoke variations of the same PDS rules result in confusion about financial products.

Adviser assessments, comparisons and information
Generalisations in the FSG requirements results in there being virtually no verifiable rating scale for advisers who are outside of CFP nor for those advisers who have been deregistered or banned.

Publishing information about adjudicated complaints and their severity, identifying licensees that have had enforceable undertakings with ASIC, revealing average client retention rates and ranking advisers' investment performance would provide more information about an adviser's past performance than is currently available.

A rating system for products and advisers as simple as the water and power efficiency star ratings for white goods or even the safety ANCAP ratings in the car industry would be a significant improvement.

"Appropriateness of advice"
It gets harder as getting the right information at the right time is more difficult using a digital interface rather than human intuition. How can we be comfortable that we have all the relevant information about a person's financial and other circumstances when there is limited ability to have:

- Reactive questioning
- Non-verbal queues
- Intuitively assess decision making dynamics of couples
- Assessed client's level of understanding of questions, let alone level of mental competence, possible coercion or duress etc

Therefore we suggest digital advisers need a higher standard to provider further reassurance to the public. We see both the "fee for service" model and independence of ownership of the robo adviser as providing additional layers of assurance for the appropriateness of advice. Independance has the obvious advantage of limiting conflicts between the adviser's and client's interests.

The "fee for service approach" is well recognised within the industry but we have concerns that some larger vertically integrated groups in the industry see "digital advice" channels as a new avenues for further distribution. This is contrary to a scaled appropriate advice delivery channel offered in combination with valuable financial tools, calculators, research and educational tools.

We do believe everyone could benefit from some level of personal financial advice but we know that the most significant element missing is education, to enable clients to make informed decisions.

The harm from not making an informed opinion is much greater than the possible harm of getting factual information or general information that is not tailored to your exact situation. We believe we offer both an educational/self-directed stream and an advice/recommended stream and that the different streams are absolutely obvious as they need to be.

Advice Document Review
We note your minimum requirements for regular reviews by an offline adviser. We suggest an extension of the annual client external reviews to include an external review of a number of different scenarios from the digital advice provider. Again an opportunity for ASIC to set high standards and enforce annual external advice reviews.

Summary

The power of scaling and leveraging technology to safely and efficiently decrease the education, insurance and retirement savings (versus expected income in retirement) gap is immense.
We believe that ASIC has a one-time opportunity to force the digital advice standards higher than the current drafts of traditional adviser requirements. The newness of the industry means that there is no transition required.

If the foundations of scaled personal advice are squeaky clean and are perceived to be squeaky clean then confidence in digital financial advice will build naturally.

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